2021

Annual reports

- on the implementation of the EU budget for the 2021 financial year and
- on the activities funded by the 8th, 9th, 10th and 11th European Development Funds (EDFs) for the 2021 financial year

the Court of Auditors of the European Union, at its meetings of 7 and 14 July 2022, adopted its

ANNUAL REPORTS
for the 2021 financial year

The reports, together with the institutions’ replies to the Court’s observations, have been sent to the authorities responsible for giving discharge and to the other institutions.

The Members of the Court of Auditors at the time these reports were adopted were:

## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual report on the implementation of the EU budget for the 2021 financial year</td>
<td>5</td>
</tr>
<tr>
<td>Institutions’ replies to the annual report on the implementation of the EU budget for the 2021 financial year</td>
<td>279</td>
</tr>
<tr>
<td>Annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds for the 2021 financial year</td>
<td>347</td>
</tr>
<tr>
<td>European Commission’s replies to the annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds for the 2021 financial year</td>
<td>381</td>
</tr>
</tbody>
</table>
Annual report on the implementation of the EU budget for the 2021 financial year
# Contents

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>General introduction</td>
<td>7</td>
</tr>
<tr>
<td>Chapter 1</td>
<td>The statement of assurance and supporting information</td>
<td>10</td>
</tr>
<tr>
<td>Chapter 2</td>
<td>Budgetary and financial management</td>
<td>57</td>
</tr>
<tr>
<td>Chapter 3</td>
<td>Revenue</td>
<td>94</td>
</tr>
<tr>
<td>Chapter 4</td>
<td>Single Market, Innovation and Digital</td>
<td>117</td>
</tr>
<tr>
<td>Chapter 5</td>
<td>Cohesion, resilience and values</td>
<td>139</td>
</tr>
<tr>
<td>Chapter 6</td>
<td>Natural resources and environment</td>
<td>180</td>
</tr>
<tr>
<td>Chapter 7</td>
<td>Migration and border management Security and defence</td>
<td>206</td>
</tr>
<tr>
<td>Chapter 8</td>
<td>Neighbourhood and the world</td>
<td>225</td>
</tr>
<tr>
<td>Chapter 9</td>
<td>European public administration</td>
<td>243</td>
</tr>
<tr>
<td>Chapter 10</td>
<td>Recovery and Resilience Facility</td>
<td>257</td>
</tr>
<tr>
<td></td>
<td>Institutions' replies</td>
<td>279</td>
</tr>
</tbody>
</table>
Introduction

0.1. The European Court of Auditors (ECA) is an institution\(^1\) of the European Union (EU) and the external auditor of the EU’s finances\(^2\). In this capacity, we act as the independent guardian of the financial interests of all EU citizens, notably by helping to improve the EU’s financial management. More information on our work can be found in our annual activity reports, our special reports, our review documents and our opinions on new or updated EU laws or other decisions with financial management implications, all of which are available on our website.

0.2. The EU’s general budget is adopted annually by the Council of the European Union and by the European Parliament. In May 2020, the Council of the European Union adopted NextGenerationEU (NGEU), a temporary instrument that was set up in response to the socio-economic impact of the COVID-19 pandemic and is financed through issuing bonds. NGEU provides funding for the Recovery and Resilience Facility (RRF)\(^3\), accounting for about 90 % of NGEU funding, as well as for several programmes under 2021–2027 MFF headings, which is spent in line with sector-specific rules.

0.3. Both the EU’s general budget and NGEU funding are subject to the discharge procedure. Through this procedure, the Parliament, acting on a recommendation from the Council, decides whether the European Commission has satisfactorily met its budgetary responsibilities. Our annual report, combined as appropriate with our other products, provides a basis for the discharge procedure. Upon publication, we forward our annual report to Member States’ national parliaments, the European Parliament and the Council.

---

1 The ECA was established as an institution by Article 13 of the Treaty on European Union, also known as the Maastricht Treaty. However, it was first established by the Treaty of Brussels in 1977, as the new Community body responsible for the external audit function.

2 Articles 285 to 287 of the Treaty on the Functioning of the European Union (TFEU).

0.4. Our 2021 annual report is once again split into two separate parts. This part of the report concerns the reliability of the EU consolidated accounts and the legality and regularity of transactions. The other part covers our reporting on the performance of the EU budget at the end of 2021.

0.5. The central element of our annual report is the statement of assurance on the reliability of the EU consolidated accounts and the legality and regularity of transactions. This statement is supplemented by specific assessments for major areas of EU budget spending.

0.6. This part of our report is structured as follows:

— **chapter 1** contains the statement of assurance, a summary of the results of our audit on the reliability of accounts and the legality and regularity of transactions, including the Commission’s regularity information and a summary of our audit approach;

— **chapter 2** presents our analysis of budgetary and financial management;

— **chapter 3** presents our findings on EU revenue;

— **chapters 4-9** show, for the headings of the 2021-2027 multiannual financial framework (MFF), the results of our testing of the legality and regularity of transactions and our review of the Commission’s annual activity reports, elements of its internal control systems and other governance arrangements.

— **chapter 10** presents, for the first time, the results of our work on the legality and regularity of RRF transactions and our audit approach.

0.7. As there are no separate financial statements for individual MFF headings, the conclusions for each chapter do not constitute an audit opinion. Instead, the chapters describe significant issues specific to each MFF heading.

---

4 Hereafter in chapters 1-10, we use the term ‘regularity’ with the same meaning as ‘legality and regularity’.

5 ‘Report of the European Court of Auditors on the performance of the EU budget – Status at the end of 2021’.
0.8. We aim to present our observations in a clear and concise way. We cannot always avoid using terms specific to the EU, its policies and budget, or to accounting and auditing. On our website, we have published a glossary with explanations of most of these specific terms. The terms defined in the glossary appear in *italics* when they first appear in each chapter.

0.9. It is our responsibility, as external auditor, to report our audit findings and draw the necessary conclusions in order to provide an independent and impartial assessment of the reliability of the EU accounts and the legality and regularity of transactions.

0.10. The Commission’s replies to our observations (and, where appropriate, the replies of other EU institutions and bodies) are presented together with this report.
Chapter 1

The statement of assurance and supporting information
Contents

The ECA’s Statement of Assurance provided to the European Parliament and the Council – independent auditor’s report 1.-XL.

Introduction 1.1.-1.7.
The role of the European Court of Auditors 1.1.-1.5.
EU spending is a significant tool for achieving policy objectives 1.6.-1.7.

Audit findings for the 2021 financial year 1.8.-1.46.
Reliability of the accounts 1.8.-1.11.
The accounts were not affected by material misstatements 1.8.-1.10.
Key audit matters relating to the 2021 financial statements 1.11.

Regularity of transactions 1.12.-1.32.
Our audit covers revenue and expenditure transactions underlying the accounts 1.13.-1.17.
Error continues to be present in specific types of spending 1.18.
The complexity of rules and the way EU funds are disbursed have an impact on the risk of error 1.19.-1.32.

The Commission’s regularity information 1.33.-1.46.
The Commission’s estimate of error is below our range 1.35.-1.39.
The Commission’s risk assessment is likely to underestimate the level of risk 1.40.-1.41.
The Commission’s reporting on financial corrections and recoveries has improved, but the presentation could lead to misunderstanding 1.42.-1.45.
The impact of the rule-of-law procedure on the regularity of 2021 expenditure is unclear 1.46.

We report suspected fraud to OLAF and the EPPO 1.47.-1.53.

Conclusions 1.54.-1.58.
Audit results 1.55.-1.58.
Annexes

Annex 1.1 – Audit approach and methodology
The ECA’s Statement of Assurance provided to the European Parliament and the Council – independent auditor’s report

Opinion

I. We have audited:

(a) the consolidated accounts of the European Union, which comprise the consolidated financial statements\(^1\) and the budgetary implementation reports\(^2\) for the financial year ended 31 December 2021, approved by the Commission on 28 June 2022;

(b) the legality and regularity of the underlying transactions, as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU).

Reliability of the accounts

Opinion on the reliability of the accounts

II. In our opinion, the consolidated accounts of the European Union (EU) for the year ended 31 December 2021 present fairly, in all material respects, the EU’s financial position as at 31 December 2021, the results of its operations, its cash flows and the changes in its net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

---

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

2 The budgetary implementation reports also comprise explanatory notes.
Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue

III. In our opinion, the revenue underlying the accounts for the year ended 31 December 2021 is legal and regular in all material respects.

Expenditure

IV. For 2021, we provide two separate opinions on the legality and regularity of expenditure. This reflects the fact that the Recovery and Resilience Facility (RRF) is a temporary instrument delivered and financed in a way that is fundamentally different to normal budget spending under the multiannual financial framework (MFF).

Adverse opinion on the legality and regularity of budget expenditure

V. In our opinion, owing to the significance of the matter described under ‘Basis for adverse opinion on the legality and regularity of budget expenditure’, the budget expenditure accepted in the accounts for the year ended 31 December 2021 is materially affected by error.

Opinion on the legality and regularity of RRF expenditure

VI. In our opinion, the RRF expenditure accepted in the accounts for the year ended 31 December 2021 is legal and regular in all material respects.

Basis for opinion

VII. We have conducted our audit in accordance with the International Federation of Accountants (IFAC) International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under these standards and codes are described in more detail in the ‘Auditor’s responsibilities’ section of our report. In that section, we also provide more information on the basis for our opinion on revenue (see paragraph XXXV) and RRF expenditure (see paragraph XXXVII). We have also met independence requirements and fulfilled our ethical obligations under the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions.
Basis for adverse opinion on the legality and regularity of budget expenditure

VIII. Our overall estimated level of error for budget expenditure accepted in the accounts for the year ended 31 December 2021 is 3.0 %. A substantial proportion of this expenditure is materially affected by error. This mainly concerns reimbursement-based expenditure, in which the estimated level of error is 4.7 %. Such expenditure increased to €90.1 billion in 2021, representing 63.2 % of our audit population3. The effects of the errors we found are therefore both material and pervasive to the year's accepted expenditure.

Key audit matters

We assessed the liability for pension and other employee benefits

IX. The EU balance sheet includes a liability for pension and other employee benefits amounting to €122.5 billion at the end of 2021 (2020: €116.0 billion), representing almost one quarter of the total 2021 liabilities of €496.4 billion (2020: €313.5 billion).

X. Most of the liability for pension and other employee benefits relates to the Pension Scheme of Officials and Other Servants of the European Union (PSEO), amounting to €109.7 billion (2020: €100.7 billion). The liability recorded in the accounts is an estimate of the present value of expected future payments the EU will have to make to settle its pension obligations.

XI. The benefits paid under the pension scheme are charged to the EU budget. While the EU has not created a dedicated pension fund to cover the cost of future pension obligations, Member States jointly guarantee the payment of the benefits, and officials contribute one third of the cost of financing the scheme. Eurostat calculates this liability annually on behalf of the Commission’s accounting officer, using parameters such as the age profile and life expectancy of EU officials and assumptions about future economic conditions. These parameters and assumptions are also assessed by the Commission’s actuarial advisors.

XII. The increase in the pension liability in 2021 is mainly due to the decrease in the nominal discount rate, which is affected by a reduction in global interest rates4.

XIII. The second largest part of the liability for pension and other employee benefits is the EU’s estimated liability towards the Joint Sickness Insurance Scheme (JSIS), which amounted to €10.3 billion at the end of 2021 (2020: €12.9 billion). This liability relates to EU staff members’ healthcare costs payable during post-activity periods (net of their contributions).
XIV. As part of our audit, we assess the actuarial assumptions made for these schemes and the resulting valuation. We base our evaluation on work carried out by external, independent actuarial experts. We check the basic data underlying the calculations, the actuarial parameters and the calculation of the liability. We also examine the presentation of the liabilities in the consolidated balance sheet and the notes to the consolidated financial statements.

XV. We conclude that the estimate of the overall liability for pension and other employee benefits stated in the consolidated balance sheet is fair and reliable.

We assessed significant year-end estimates presented in the accounts

XVI. At the end of 2021, the estimated value of incurred eligible expenses due to beneficiaries but not yet claimed was €129.9 billion (2020: €107.8 billion). These amounts were recorded as accrued expenses.

XVII. The increase in that estimate relates mainly to the RRF, which is the centrepiece of NextGenerationEU (NGEU), the temporary recovery instrument to help repair the immediate economic and social damage brought about by the COVID-19 pandemic. Payments to Member States under this facility follow a predefined instalment profile up to 2026. At the end of 2021, accrued RRF expenditure amounted to €12.3 billion.

XVIII. In order to assess these year-end estimates, we examined the system the Commission had set up for the cut-off calculations to ensure its correctness and completeness in the directorates-general where most expenses were incurred. During our audit work on the sample of invoices and pre-financing payments, we examined the relevant cut-off calculations in order to address the risk of accruals being misstated. We sought clarification from the Commission’s accounting services on the general methodology for establishing these estimates.

XIX. We conclude that the estimate of the overall amount of accrued charges and other advances to Member States is presented fairly in the consolidated balance sheet.

---

3 We provide further information in paragraphs 1.22-1.27 of our 2021 annual report.

4 2021 EU annual accounts, note 2.9.

5 These comprise accrued charges of €77.8 billion on the liabilities side of the balance sheet and, on the assets side, €52.1 billion reducing the value of pre-financing.
We reviewed the asset generated by the UK’s withdrawal process

XX. On 1 February 2020, the United Kingdom (UK) ceased to be an EU Member State. Under the withdrawal agreement, the UK committed to honour all financial obligations under previous MFFs arising from its EU membership. During the transition period, which ended on 31 December 2020, the UK continued to contribute to and benefit from the EU budget as if it were a Member State.

XXI. Following the end of transition period, further mutual obligations on the part of the EU and the UK give rise to certain liabilities and receivables for the EU. These obligations must be reflected in the EU’s annual accounts. The Commission estimated that, at the balance sheet date, the EU accounts showed a net receivable due from the UK of €41.8 billion (2020: €47.5 billion), of which it is estimated that €10.9 billion will be paid in the 12 months following the reporting date.

XXII. The payment mechanism to be applied to the mutual obligations under the withdrawal agreement is set out in Article 148 (‘Payments after 2020’) of the agreement. In 2021, the amount reported as being due from the UK under Article 136, and Articles 140 to 147, was €11.9 billion. The total payments received from the UK in 2021 amounted to €6.8 billion. The remaining balance at the end of the year, amounting to €5.1 billion, was payable in five equal monthly instalments from January to May 2022 inclusive, in line with the mechanism set out in Article 148 of the withdrawal agreement.

XXIII. As part of our normal audit procedures, we discussed with the Commission the timing, accuracy and completeness of the asset recognised and payments made. We recalculated the amounts concerned, reconciled them with the underlying records and checked the appropriateness of any assumptions used.

XXIV. We conclude that the estimate of the total asset recognised in relation to the UK’s withdrawal process is presented fairly in the consolidated annual accounts.

We assessed impact on the accounts of Russia’s invasion of Ukraine

XXV. On 24 February 2022, Russia invaded Ukraine. As the EU provides assistance to Ukraine in the form of loans and grants, we assessed the Commission’s calculations concerning the EU’s associated financial risk exposure, as well as their underlying basis, to ensure that the consequences of this significant event were reflected appropriately in the EU accounts. We assessed the Commission’s calculations against our own and against existing data on the matter.
XXVI. We conclude that the treatment of Russia’s invasion of Ukraine as a non-adjusting post balance-sheet event is appropriate. Its impact has been appropriately disclosed and presented fairly in the consolidated annual accounts.

We assessed the impact of COVID-19-related measures on the accounts

XXVII. The COVID-19 pandemic seriously affected Member States’ economies and public finances. The European Commission mobilised substantial means to reinforce the Member States’ public health sectors and mitigate the pandemic’s socio-economic impact in the EU. The action taken included funding urgent medical supplies, introducing more flexibility in utilising the financial support from the European Structural and Investment Funds and providing loans on favourable terms to Member States. These initiatives had a significant effect on the financial statements.

XXVIII. As part of our normal audit procedures, we audited the assets, liabilities, revenue and expenses, including those related to the measures taken by the Commission. We conclude that they are presented fairly in the consolidated annual accounts.

Other matters

XXIX. Management is responsible for providing ‘other information’. This term encompasses the ‘Financial highlights of the year’, but not the consolidated accounts or our report on these. Our opinion on the consolidated accounts does not cover this other information, and we do not express any form of assurance conclusion on it. Our responsibility in connection with the audit of the consolidated accounts is to read the other information and consider whether it is materially inconsistent with the consolidated accounts or the knowledge we have obtained in the audit or otherwise appears to be materially misstated. If we conclude that the other information is materially misstated, we are required to report this accordingly. We have nothing to report in this regard.

Responsibilities of management

XXX. In accordance with Articles 310 to 325 of the TFEU and with the Financial Regulation, management is responsible for preparing and presenting the EU’s consolidated accounts on the basis of internationally accepted accounting standards for the public sector, and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in
compliance with the authorities (laws, regulations, principles, rules and standards) which govern them. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EU’s accounts (Article 317 of the TFEU).

XXXI. When preparing the consolidated accounts, management is responsible for assessing the EU’s ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or cease operations, or has no realistic alternative but to do so.

XXXII. The Commission is responsible for overseeing the EU’s financial reporting process.

XXXIII. Under the Financial Regulation (Title XIII), the Commission’s accounting officer must present for audit the consolidated accounts of the EU first as provisional accounts by 31 March of the following year and as final accounts by 31 July. The provisional accounts should already give a true and fair view of the EU’s financial position. It is therefore imperative that all items of the provisional accounts are presented as final calculations, allowing us to perform our task in line with (Title XIII) of the Financial Regulation and by the given deadlines. Any changes between the provisional and final accounts would normally result from our observations only.

Auditor’s responsibilities for the audit of the consolidated accounts and underlying transactions

XXXIV. Our objectives are to obtain reasonable assurance as to whether the EU’s consolidated accounts are free from material misstatement and the underlying transactions are legal and regular and on the basis of our audit, to provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence any economic decisions taken on the basis of these consolidated accounts.

XXXV. For revenue, our examination of VAT and GNI-based own resources takes as its starting point the macroeconomic aggregates from which these are calculated, and assesses the Commission’s systems for processing these up to the point at which the Member States’ contributions have been received and recorded in the consolidated accounts. For traditional own resources, we examine the
customs authorities’ accounts and analyse the flow of duties up until the amounts have been received by the Commission and recorded in the accounts. Customs duties are at risk of either not being declared or being declared incorrectly to the national customs authorities by importers. The actual import duties collected will therefore fall short of the amount that should theoretically be collected. This difference is known as the “customs gap”. These evaded amounts are not captured in Member States’ TOR accounting systems and do not fall within the scope of our audit opinion on revenue.

XXXVI. For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments at the point they are made, except advances. We examine advance payments once the recipient of funds has provided evidence of their proper use and the institution or body has accepted that evidence by clearing the advance payment, which might not happen until a subsequent year.

XXXVII. This year, for the first time, we examined RRF expenditure. Unlike other budget expenditure, which is based on the reimbursement of costs and/or compliance with conditions, under the RRF the condition for payment is the satisfactory achievement of predefined milestones or targets. We therefore examined whether the Commission had gathered sufficient and appropriate evidence to support its assessment of this condition. Compliance with other EU and national rules does not form part of this assessment.

XXXVIII. We exercise professional judgement and maintain professional scepticism throughout the audit. We also:

(a) Identify and assess the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of EU law, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

(b) Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

(c) Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management’s accounting estimates and related disclosures.
(d) Conclude as to the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the consolidated accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.

(e) Evaluate the overall presentation, structure and content of the consolidated accounts, including all disclosures, and assess whether the consolidated accounts fairly represent the underlying transactions and events.

(f) Obtain sufficient appropriate audit evidence regarding the financial information on the entities covered by the EU’s scope of consolidation to express an opinion on the consolidated accounts and the underlying transactions. We are responsible for directing, supervising and carrying out the audit, and are solely responsible for our audit opinion.

XXXIX. We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including findings of any significant deficiencies in internal control.

XL. Of the matters discussed with the Commission and other audited entities, we determine which were of most significance in the audit of the consolidated accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

14 July 2022

Klaus-Heiner LEHNE
President

European Court of Auditors
12, rue Alcide De Gasperi – L-1615 Luxembourg
Introduction

The role of the European Court of Auditors

1.1. We are the EU’s independent auditor. In accordance with the Treaty on the Functioning of the European Union (TFEU)\(^6\), we:

(a) give our opinion on the EU’s accounts;

(b) check whether the EU budget is used in accordance with applicable laws and regulations;

(c) report on whether EU spending is economic, efficient and effective\(^7\); and

(d) advise on proposed legislation with impact on the financial management of EU funds or related aspects.

1.2. Our work for the *statement of assurance* (explained in Annex 1.1) fulfils the first and second of these objectives. We present performance aspects of the budget’s implementation (the economy, efficiency and effectiveness of spending) in a separate part of our annual report\(^8\). Taken together, our audit work also provides a key input into our opinions on proposed legislation.

1.3. This chapter of the annual report:

(a) sets out the background to our statement of assurance and gives an overview of our findings and conclusions on the reliability of accounts and the regularity of the underlying transactions, including the Commission’s regularity information;

(b) includes information on our reporting of cases of suspected fraud to the EU’s anti-fraud office (OLAF) and the European Public Prosecutor’s Office (EPPO) and our audits on EU action to combat fraud;

(c) summarises our audit approach (see Annex 1.1).

---

\(^6\) Articles 285 to 287 of the Treaty on the Functioning of the European Union (TFEU).

\(^7\) In accordance with the principle of *sound financial management*.

\(^8\) We report on these aspects in ‘Report of the European Court of Auditors on the performance of the EU budget – Status at the end of 2021’ and our performance-related special reports.
1.4. In 2021, our work also covered the single payment made to Spain from the RRF. The RRF is the main component of the NGEU package, which is aimed at supporting recovery from the impact of the COVID-19 pandemic. The results of this work form the basis for our 2021 opinion on the regularity of RRF expenditure. The RRF is a temporary instrument delivered and financed in a way that is fundamentally different to budget spending under the MFFs. We have therefore decided to devote a separate chapter (chapter 10) to RRF expenditure, presenting our audit approach, the background to our work and an overview of our findings and conclusions. Chapter 1 therefore does not cover the RRF, focusing exclusively on EU budget spending under MFF headings 1 to 7.

1.5. COVID-19 travel and public health restrictions continued to restrict our ability to carry out on-the-spot checks, obtain original documents, interview auditee staff face to face and verify the physical existence of EU-funded outputs. We therefore continued to adjust to this situation and transform the way we work, carrying out most of our work through desk reviews and interviewing auditees remotely. The lack of on-the-spot checks means that an increased detection risk remains; nevertheless, we consider that the evidence obtained from our auditees enabled us to complete and conclude on our work.

EU spending is a significant tool for achieving policy objectives

1.6. EU spending is an important tool for achieving policy objectives, but not the only one. Other important measures include the use of legislation and the right to free movement of goods, services, capital and people throughout the EU. In 2021, Member States’ total general government spending (€7 459 billion) represented 53 % of their gross national income (€14 069 billion). EU budget spending, amounted to

---

9 Regulation (EU) 2021/241 establishing the RRF.


11 Detection risk is the risk that the auditor will not detect a deviation that has not been corrected by the entity’s internal controls.

12 Paragraph 1.4 of our 2020 annual report.

13 'EU budget spending’ includes NGEU funding for several programmes under 2021–2027 MFF headings, which is spent in line with sector-specific rules. However, it excludes RRF
€181.5 billion, representing 2.4% of the EU Member States’ total general government spending and 1.3% of their gross national income (see **Figure 1.1**). Taking into account additional payments from assigned revenue for RRF grants €46.5 billion, payments in 2021 totalled €228.0 billion\(^{14}\).

**Figure 1.1** – 2021 EU budget spending and general government expenditure as a share of gross national income (GNI)

![Pie chart showing the distribution of EU budget spending](chart.png)

**Source:**
EU 27 GNI: 2021 consolidated annual accounts of the European Commission – Annex A – Revenue
EU 27 general government expenditure: Eurostat database — Government revenue, expenditure and main aggregates; Data extracted on 25.04.2022;

**1.7.** EU funds are disbursed to beneficiaries either through single payments/annual instalments or through a series of payments within multiannual spending schemes. Payments from the 2021 EU budget comprised €144.4 billion in single, interim or final payments, plus €37.1 billion in pre-financing. As **Figure 1.2** shows, the largest shares of the EU budget went to 'Cohesion, resilience and values' and 'Natural resources and environment', followed by 'Single market, innovation and digital'.

---

\(^{14}\) 2021 consolidated annual accounts of the EU, budgetary implementation reports and explanatory notes, 6.3 MFF: Implementation of payment *appropriations*. 
Figure 1.2 – 2021 EU budget spending per multiannual financial framework (MFF) heading

Source: ECA.

MFF 1 (Chapter 4)  Single market, innovation and digital
MFF 2 (Chapter 5)  Cohesion, resilience and values
MFF 3 (Chapter 6)  Natural resources and environment
MFF 4 (Chapter 7)  Migration and border management
MFF 5 (Chapter 7)  Security and defence
MFF 6 (Chapter 8)  Neighbourhood and the world
MFF 7 (Chapter 9)  European public administration
Special instruments (outside MFF)

Source: ECA.
Audit findings for the 2021 financial year

Reliability of the accounts

The accounts were not affected by material misstatements

1.8. Our findings concern the EU’s consolidated accounts\(^{15}\) (the 'accounts') for the 2021 financial year. We received them, together with the accounting officer’s letter of representation, on 28 June 2022, before the final date for presentation allowed under the Financial Regulation\(^{16}\). The accounts are accompanied by a 'Financial highlights of the year' section\(^{17}\), which is not covered by our audit opinion. In accordance with auditing standards, however, we have assessed its consistency with the information in the accounts.

1.9. The accounts published by the Commission show that, at 31 December 2021, total liabilities amounted to €496.4 billion, compared with €414.1 billion of total assets. The difference of €82.3 billion represented the (negative) net assets, comprising reserves and the portion of expenses already incurred by the EU up to 31 December that must be funded by future budgets. The economic result for 2021 was €42.1 billion.

\(^{15}\) The consolidated accounts comprise:
(a) the consolidated financial statements covering the balance sheet (presenting the assets and liabilities at the end of the year), the statement of financial performance (recognising the income and expenses of the year), the cash-flow statement (disclosing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets, as well as the notes to the financial statements;
(b) the budget implementation reports covering the revenue and expenditure for the year, as well as the related notes.

\(^{16}\) Regulation (EU, Euratom) No 2018/1046 on the financial rules applicable to the general budget of the Union.

\(^{17}\) Recommended Practice Guideline 2 (RPG 2) – ‘Financial Statement Discussion and Analysis’ of the International Public Sector Accounting Standards Board (IPSASB).
1.10. Our audit found that the accounts were not affected by material misstatements. We present the results of our work on the financial and budgetary management of EU funds in chapter 2.

Key audit matters relating to the 2021 financial statements

1.11. Key audit matters are those matters that, according to our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, but we do not provide a separate opinion on these matters. We report on key audit matters in our statement of assurance.

Regularity of transactions

1.12. We examined the EU’s revenue and expenditure to assess whether its resources had been collected and spent in compliance with the applicable laws and regulations. We present our audit results for revenue in chapter 3 and for expenditure in chapters 4-9. We report on the RRF in chapter 10.

Our audit covers revenue and expenditure transactions underlying the accounts

1.13. For revenue, we obtained reasonable assurance for our audit opinion by assessing selected key systems, complemented by transaction testing. The sample of transactions examined was designed to be representative of all sources of EU budgetary revenue, which comprises four categories of own resources and revenue stemming from other sources. Our sample additionally included external assigned revenue used to finance the non-repayable (grant) component of the RRF (see paragraphs 3.2-3.4).

---

18 Including transactions from the 2014–2020 and previous MFFs.

19 This includes the amounts borrowed by the Commission to provide non-repayable financial support to Member States under NGEU. The EU will have to repay these amounts in the future.
1.14. For expenditure, we defined a representative sample of 740 transactions, comprising transfers of funds from the EU budget to final recipients of EU spending (see paragraphs (12) and (13) of Annex 1.1). Our testing of these transactions contributed to our statement of assurance and our estimation of the proportion of irregular transactions in the overall audit population, in high-risk and low-risk expenditure (see paragraph 1.19) and in each MFF heading where we provide a specific assessment (headings 1, 2, 3 and 7).

1.15. In 2021, our audit population for testing revenue amounted to €239.6 billion\(^{20}\) (see Figure 3.1) and our population for testing expenditure totalled €142.8 billion\(^{21}\). These amounts include both contributions from and payments to the United Kingdom, in line with the conditions outlined in the withdrawal agreement\(^{22}\).

1.16. Figure 1.3 shows our audit population for testing expenditure – broken down into single, interim (where accepted by the Commission) and final payments; clearings of pre-financing; and annual decisions to accept the accounts – in comparison with EU spending per MFF heading (see paragraph (12) of Annex 1.1).

---

\(^{20}\) Budgetary revenue of €184.1 billion and assigned revenue (for the non-repayable RRF support) of €55.5 billion; 2021 consolidated annual accounts of the EU, Table 2 under 'Budgetary implementation reports and explanatory notes'.

\(^{21}\) Including NGEU funding for several programmes under 2021–2027 MFF headings, which is spent in line with sector-specific rules.

\(^{22}\) Articles 136 and 138 of the agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community.
Figure 1.3 – Comparison of our audit population (€142.8 billion) and EU budget spending (€181.5 billion) by MFF heading in 2021

- **Single, interim, and final payments**
- **Pre-financing payments** (including advances to financial engineering instruments, the European Fund for Strategic Investments, agencies and the Guarantee Fund for External Actions)
- **Clearing of pre-financing** (including trust fund disbursements for MFF 6 and 2019 and 2020 payments for OPs closed in 2021 for MFF 2)
- **Annual decision to accept the accounts** (for expenditure from 2014-2020 and 2007-2013 programming periods)

<table>
<thead>
<tr>
<th>Category</th>
<th>Single, interim, and final payments</th>
<th>Pre-financing payments</th>
<th>Clearing of pre-financing</th>
<th>Annual decision to accept the accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single market, innovation and digital</td>
<td>18.5</td>
<td>14.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cohesion, resilience and values (*)</td>
<td>80.1</td>
<td>47.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Natural resources and environment</td>
<td>56.8</td>
<td>56.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Migration and border management</td>
<td>2.5</td>
<td>2.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Security and defence</td>
<td>0.7</td>
<td>0.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Neighbourhood and the world</td>
<td>10.9</td>
<td>10.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>European public administration</td>
<td>10.7</td>
<td>10.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Special instruments</td>
<td>1.3</td>
<td>0.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(*) For 'Cohesion, resilience and values', there were €63.0 billion of interim payments for the 2014-2020 programming period that were not included in the accounts underlying the assurance packages accepted by the Commission in 2021 (see Figure 5.1). These interim payments are included in the €78.7 billion pre-financing and thus were not part of our audit population for the 2021 annual report. They will be included in our audit population in the year the Commission accepts the corresponding accounts (e.g. in the 2022 statement of assurance for payments from the 2020/2021 accounting year).

Source: ECA.
1.17. Figure 1.4 shows that 'Natural resources and environment' makes up the largest share of our overall population (39.7 %), followed by 'Cohesion, resilience and values' (33.5 %) and 'Single market, innovation and digital' (10.0 %).

**Figure 1.4 – Overview of our 2021 audit population of €142.8 billion by MFF heading**

Error continues to be present in specific types of spending

1.18. For the regularity of EU revenue and expenditure, our key findings were:

(a) For revenue, the overall audit evidence indicates that the level of error in revenue was not material. The revenue-related systems we examined were generally effective. However, the key internal traditional own resources (TOR) controls we assessed in certain Member States and the management of VAT reservations and TOR open points at the Commission were partially effective due to persistent weaknesses (see paragraphs 3.10-3.12 and 3.15-3.17). We also found that the implementation of several actions in the Commission’s Custom Action Plan that contribute to reducing the customs gap had been delayed (see paragraph 3.13). This weakness does not affect our audit opinion on revenue, as it does not concern the transactions underlying the accounts but rather the risk that TOR are incomplete.
For expenditure, our audit evidence indicates that the overall level of error was material at 3.0% (see Figure 1.5). 'Cohesion, resilience and values' was the biggest contributor to this rate (1.2 percentage points), followed by 'Natural resources and environment' (0.7 percentage points), 'Neighbourhood and the world' (0.4 percentage points) and 'Single market, innovation and digital' (0.4 percentage points). Material error continues to be present in high-risk expenditure, which is mainly reimbursement-based (see paragraphs 1.19 and 1.22-1.23). Such expenditure represented 63.2% of our audit population.

Figure 1.5 – Estimated level of error and audit population (2017–2021)

Note: We define error as an amount of money that should not have been paid out from the EU budget. Errors occur when money is not used in accordance with the relevant EU legislation and hence not as the Council of the European Union and the European Parliament intended when adopting that legislation, or when it is not used in accordance with specific national rules.

Source: ECA.

---

23 We have 95% confidence that the estimated level of error in the population lies between 2.2% and 3.8% (the lower and upper level error limits respectively).
The complexity of rules and the way EU funds are disbursed have an impact on the risk of error

1.19. Following our risk analysis, which is based on our past audit results and assessment of management and control systems, we divided our audit population of underlying transactions into high-risk and low-risk expenditure in order to select our representative sample. We consider that:

— The risk of error is lower for expenditure subject to simplified rules. This type of expenditure encompasses mainly those entitlement-based payments for which beneficiaries must meet certain – often simple – conditions, as well as part of administrative expenditure (salaries and pensions of EU civil servants).

— The risk of error is high for expenditure subject to complex rules. This is mainly the case for reimbursement-based payments, where beneficiaries have to submit claims for eligible costs they have incurred. To this end, as well as demonstrating that they are engaged in an activity eligible for support, they must provide evidence of the reimbursable costs they have incurred. In doing so, they must often follow complex rules regarding what can be claimed (eligibility) and how costs can be properly incurred (public procurement or state aid rules).

1.20. In 2021, we continued to find that low-risk expenditure was free from material error but that high-risk expenditure remained affected by material error. Our 2021 audit results therefore reaffirm our assessment, as reflected in our risk analysis and classification, that the way funds are disbursed has an impact on the risk of error.

1.21. Figure 1.6 and paragraphs 1.22-1.31 provide more information on the high-risk population and the errors we found therein.
A substantial proportion of our audit population is affected by material error

1.22. High-risk expenditure represents 63.2% of our audit population and has increased slightly compared to last year, when it represented around 59.0%. Figure 1.7 shows that ‘Cohesion, resilience and values’ makes up the largest share of our high-risk population (€46.3 billion), followed by ‘Natural resources and environment’ (€18.4 billion), ‘Single market, innovation and digital’ (€10.8 billion) and ‘Neighbourhood and the world’ (€8.8) billion. A summary of our findings for each of these headings is given in paragraphs 1.24-1.27.

1.23. Taking into account the results of our testing across all MFF headings, we estimate the level of error in high-risk expenditure at 4.7% (2020: 4.0%), which exceeds the materiality threshold of 2.0% (see Figure 1.6).
Figure 1.7 – Breakdown of high-risk and low-risk expenditure by MFF heading

**High risk expenditure**
€90.1 bn (63.2 %)
Expenditure subject to complex rules, mostly reimbursement-based payments

**Low risk expenditure**
€52.7 bn (36.8 %)
Mostly entitlement-based payments

Source: ECA.

1.24. ‘Cohesion, resilience and values’ (chapter 5): expenditure in this area is mainly implemented through the European Regional Development Fund, the Cohesion Fund and the European Social Fund. It is predominated by reimbursement-based payments, which we consider to be high-risk. The main types of error that we found and quantified were ineligible costs and projects, absence of essential supporting documents, infringements of internal market rules (in particular non-compliance with state aid rules) and non-compliance with public procurement rules.
1.25. 'Natural resources and environment' (chapter 6): for spending areas we had identified as high-risk (rural development, market measures and the other MFF heading 3 policy areas outside the common agricultural policy (CAP), representing around 32.6% of expenditure under this heading, we once again found a material level of error. Expenditure in these areas mainly takes the form of reimbursement. Ineligible beneficiaries or expenditure, administrative errors and failure to meet agri-environmental commitments are the most common errors found in this area.

1.26. 'Single market, innovation and digital' (chapter 4): as in previous years in this area, research expenditure (Horizon 2020 and the Seventh Framework Programme) remains high-risk and the main source of errors. Errors in this area include different categories of ineligible costs (in particular ineligible direct personnel costs and other direct costs). In addition, we found and quantified errors under other programmes and activities (mainly the Connecting Europe Facility). Non-compliance with public procurement rules and ineligible costs are the most common errors found in this area.

1.27. 'Neighbourhood and the world' (chapter 8): expenditure in this area is mostly reimbursement-based and covers external action funded by the EU budget. All types of expenditure under this heading are considered high-risk, except for budget support payments and administrative expenditure, which represent around 11.7%. Most errors found in the high-risk expenditure in this area concern expenditure not incurred, absence of essential supporting documents, ineligible costs and non-compliance with public procurement rules.
Eligibility errors still contribute most to the estimated level of error for high-risk expenditure

1.28. As we have done in recent years, we describe in detail below the error types found in high-risk expenditure, as this is where material error persists. Figure 1.8 shows the contribution of each error type to the estimated level of error for high-risk expenditure in 2021, alongside the estimates from 2017 to 2021.

Figure 1.8 – Contribution to the 2021 estimated level of error for high-risk expenditure, by error type

A) The 2021 estimated level of error in high-risk expenditure is 4.7 %

B) The distribution of error types is as follows

- Errors including those by the Commission and intermediary bodies: 5.5%
- Payments lacking supporting documentation: 12.1%
- Serious errors in public procurement, grant award procedures and state aid: 19.1%
- Ineligible projects, activities or beneficiaries: 23.7%
- Ineligible costs included in cost claims and non-compliance with environmental commitments: 39.6%

C) How the proportion of error types changed each year between 2017 and 2021

D) How the estimated level of error in high-risk expenditure changed each year between 2017 and 2021

Source: ECA.

1.29. In 2021, we continued to find eligibility errors, mainly in 'Cohesion, resilience and values', 'Natural resources and environment' and 'Single market, innovation and digital'. These made a significant contribution of 63.3 % (2020: 65.9 %) to our estimated level of error for high-risk expenditure. Of these errors, ineligible costs included in costs claims contributed 39.6 % and ineligible projects, activities or beneficiaries 23.7 %.
1.30. In 2021, we found errors relating to infringements of state aid rules in 'Cohesion, resilience and values' and of public procurement rules in 'Single market, innovation and digital', 'Neighbourhood and the world', 'European public administration' and 'Cohesion, resilience and values'. These errors contributed 19.1 % to our estimated level of error for high-risk expenditure (2020: 18.7 %).

1.31. In addition, the proportion of the estimated level of error made up of payments for which no essential supporting documentation was provided remained significant, mainly in 'Neighbourhood and the world' and 'Security and defence'. These errors contributed 12.1 % (2020: 11.4 %) to our estimated level of error for high-risk expenditure.

We did not find a material level of error in low-risk expenditure

1.32. For low-risk expenditure, which represented 36.8 % of our audit population, we conclude that the estimated level of error is below our materiality threshold of 2.0 %, as was also the case in 2019 and 2020. Low-risk expenditure mainly comprises entitlement-based payments, part of administrative expenditure ('Salaries and pensions of EU civil servants' – chapter 9) and budget support for non-EU countries ('Neighbourhood and the world'– chapter 8) (see Figure 1.7). Entitlement-based payments include direct aid for farmers ('Natural resources and environment' – chapter 6) and student and other mobility actions under Erasmus+ ('Cohesion, resilience and values' – chapter 5).

The Commission’s regularity information

1.33. The Commission is ultimately responsible for implementing the EU budget, regardless of the management mode (direct, indirect or shared management). The Commission accounts for its actions in three reports, which are included in the 'Integrated Financial Reporting Package'24:

(a) Consolidated accounts of the European Union;

(b) Annual Management and Performance Report for the EU budget (AMPR);

(c) Report on the follow-up to the discharge of the previous financial year.

24 The link to the Integrated Financial and Accountability Reporting 2021.
1.34. The AMPR summarises key information on internal control and financial management referred to in the annual activity reports (AARs) of the various Commission directorates-general (DGs). Responsibility for these reports follows the division of responsibilities set out in the Commission’s governance arrangements. The directors-general are responsible for the reliability of the information provided in their respective AARs, while the college of Commissioners adopts the AMPR and therefore ultimately has ownership of the report’s production and of the information presented therein.

The Commission’s estimate of error is below our range

1.35. In the AMPR, the Commission presents, for the transactions underlying the 2021 accounts, its estimation of the risk at payment\(^\text{25}\). The risk at payment represents the Commission’s estimate of the amount, at the moment of payment, that has been paid without being in accordance with the applicable rules. This concept is closest to our estimate of the level of error.

1.36. Figure 1.9 presents the Commission’s figures for the risk at payment alongside the range of our estimated level of error. The Commission’s risk at payment for 2021 is 1.9 %, which is below our estimated level of error of 3.0 % (2020: 2.7 %) and below our range, which is between 2.2 % and 3.8 %. Paragraphs 1.37-1.39 describe the factors contributing to the difference in the figures.

\(^{25}\) Article 247(1)(b)(i) of the Financial Regulation requires that the AMPR include an estimation of the level of error in EU expenditure.
1.37. The risk at payment is disclosed individually for each DG in the relevant AARs and as aggregate figures for each policy area (which are close to the figures for each MFF heading) and for the Commission as a whole in the AMPR. In **Figure 1.10**, we compare our estimated level of error with the Commission’s estimates for the three biggest MFF headings for which we provide a specific assessment.
Figure 1.10 – Our estimate of the 2021 level of error versus the Commission’s estimate of the risk at payment for MFF headings 1, 2 and 3

Source: ECA.
1.38. The comparison shows that the Commission figures are below our estimates for two policy areas. We found that:

— for heading 1 'Single market, innovation and digital', the Commission’s estimate of the risk at payment of 1.3 % is below our range for the estimated level of error (see paragraph 4.6).

— for heading 2 'Cohesion, resilience and values', the Commission’s estimate is 2.3 % and is in the lower half of our range, below our estimated level of error (see paragraph 5.15).

— for heading 3 'Natural resources and the environment', the Commission’s estimate of the risk at payment (1.8 %) is consistent with our estimate (see paragraph 6.14 and 6.47).

1.39. In previous annual reports, we have referred to weaknesses in ex post checks affecting the risk at payment26. The weaknesses we reported concerned ex post audits by the Commission’s Common Audit Service ('Single market, innovation and digital'), checks by Member State audit authorities ('Cohesion, resilience and values') and the annually commissioned residual error rate (RER) study ('Neighbourhood and the world').

The Commission’s risk assessment is likely to underestimate the level of risk

1.40. In the AMPR, the Commission presents its overall risk assessment of 2021 annual expenditure in order to identify and focus action on high-risk areas. The Commission divides this annual expenditure into areas with a low (less than 1.9 %), medium (between 1.9 % and 2.5 %) and high estimated risk at payment (above 2.5 %). It arrives at this split by estimating the risk at payment for each programme and other relevant expenditure segment. For 'Natural resources and the environment' and 'Cohesion, resilience and values', it estimates the overall risk at payment for individual paying agencies and operational programmes in the Member States and assigns them to the appropriate risk category (low, medium or high). Based on this approach, the Commission estimates the risk at payment to be low for 55 % of expenditure, medium for 23 % and high for 22 %.

26 Paragraph 1.37 of our 2020 annual report and Box 1.11 of our 2019 annual report.
1.41. However, our work revealed the following limitations, which, taken together, affect the robustness of the Commission’s risk assessment:

- **Heading 1 'Single market, innovation and digital'** (total relevant expenditure by the Commission: €17 billion) mainly comprises expenditure classified by the Commission as low- or medium-risk (96% of this heading’s total expenditure). However, we have previously reported weaknesses in the Commission’s *ex post* audits in this area (see paragraph 1.39), which underestimate the Commission’s estimate of risk at payment for the programmes concerned. For 2021, we estimated a level of error of 4.4% in heading 1 (see paragraph 4.6), indicating that these weaknesses still exist.

- **Heading 2 'Cohesion, resilience and values'** (total relevant expenditure by the Commission: €76 billion) comprises operational programmes classified by the Commission mainly as either low- or medium-risk (67% of this heading’s total expenditure) depending on their confirmed error rates. We recently concluded that these error rates are minimums27; this means they may have been underestimated and that some programmes may therefore have been incorrectly classified as low- or medium-risk.

- **Heading 6 'Neighbourhood and the world'** (total relevant expenditure by the Commission: €13 billion) is classified by the Commission as entirely low- or medium-risk. The error rates reported in the RER study are an important contributor to the risk at payment for this heading. We have concluded in the past 28 that limitations in the RER study may contribute to the underestimation of the risk at payment in this heading, which in turn would affect the risk classification. In addition, we continue to find a high number of quantifiable errors in 'Neighbourhood and the world' expenditure and our audit results confirm that the risk of error in this heading is high (see paragraph 8.8).

---

27 Special report 26/2021 'Regularity of spending in EU Cohesion policy: Commission discloses annually a minimum estimated level of error that is not final'.

28 Paragraphs 8.21-8.28 of our 2020 annual report.
The Commission’s reporting on financial corrections and recoveries has improved, but the presentation could lead to misunderstanding

1.42. The Commission, in line with the Financial Regulation, provides information in the AMPR on preventive and corrective measures to protect the budget from illegal or irregular expenditure. In our 2020 annual report, we found the way the 2020 AMPR presented actual financial corrections and recoveries to be complex and not always clear. This was because it presented several different amounts depending on the phase the corrections or recoveries were at (‘confirmed’ or ‘implemented’), the stage at which they were applied (following ‘ex ante’ or ‘ex post’ controls), and their impact (‘replacements’ or amounts returned to the EU budget)29.

1.43. In the 2021 AMPR, the Commission makes fewer distinctions in its presentation of actual corrections and recoveries. Firstly, it focuses on amounts ‘implemented’ (i.e. the established amount actually applied and recorded in the Commission’s accounts). Secondly, it discloses as ‘corrections’ those amounts ultimately refunded to the EU budget by Member States or final recipients. This simplification makes clearer the amount of irregular expenditure corrected and returned to the EU budget.

1.44. Figure 1.11 shows the composition of actual corrections implemented by the Commission and reported in the 2021 AMPR (€ 765 million (2020: €440 million)). Net corrections imposed on Member States in 2021 totalled €523 million (2020: €90 million), and undue payments recovered from final recipients amounted to €242 million (2020: €350 million). These amounts mainly concern 2014-2020, but also previous programming periods (with minor net corrections dating back to 1989-1993) and years (with the oldest recoveries dating back to 2005). For cohesion, as at the end of 2021, no net corrections had yet been imposed on Member States for the 2014–2020 programming period.

29 Paragraph 1.41 and Box 1.12 of our 2020 annual report.
1.45. Alongside amounts resulting from the corrections implemented by the Commission, the 2021 AMPR presents amounts resulting from its 'ex ante' preventive measures (€298 million (2020: €301 million)). It also presents measures applied by the Member States (€4 557 million), which also include an as yet undetermined amount of 'ex ante' preventive ones. The 2021 AMPR adds together all amounts resulting from preventive and corrective measures taken by both the Commission and the Member States and presents this total (€5 620 million) as 'corrections for past payments'\textsuperscript{30} and as a percentage of relevant expenditure in 2021 (3.3 \%)\textsuperscript{31}. We consider that presenting the amounts this way is inadequate and prone to misunderstanding, as preventive measures do not relate to past payments or accepted expenditure. Furthermore, Member States’ preventive measures cannot be attributed directly to the Commission.

\textsuperscript{30} 2021 AMPR, Volume II, Annex 2, section 2.1, p. 49.

\textsuperscript{31} 2021 AMPR, Volume III, Annex 5, section 5.4, pp. 31-32.
The impact of the rule-of-law procedure on the regularity of 2021 expenditure is unclear

1.46. We note that the Commission, in its AMPR, reports that it sent a first notification to Hungary in April 2022 under the 'general regime of conditionality'\(^{32}\). This triggered the procedure that may lead to the imposition of measures against a Member State for breaches of the principles of the rule of law. For the Commission to send such a notification, Article 6(1) of Regulation 2020/2092 requires it to have reasonable grounds to consider that the underlying issues affect or seriously risk affecting the sound financial management of the EU budget or the EU’s financial interests. However, the AMPR does not disclose details of the notification or how it may affect the regularity of the expenditure concerned.

\(^{32}\) Regulation (EU, Euratom) 2020/2092 on a general regime of conditionality for the protection of the Union budget.
We report suspected fraud to OLAF and the EPPO

1.47. Fraud is any intentional act or omission relating to the use or presentation of false, incorrect or incomplete statements or documents, the non-disclosure of required information and the improper use of EU funds. Fraud has the effect of harming or potentially harming the EU’s financial interests.

1.48. The primary responsibility for preventing and detecting fraud rests with both the management of an entity and those charged with its governance. Article 325 of the TFEU requires the EU and its Member States to counter fraud or other illegal activities affecting the Union’s financial interests.

1.49. As the EU’s external auditor, we do not have a mandate to investigate cases of suspected fraud against the EU’s financial interests. We take account of the risk of fraud before starting audits (see paragraphs (28)-(30) in Annex 1.1) and review our procedures regularly. We forward to OLAF (the EU’s anti-fraud office) any suspicion of fraud, corruption or other illegal activity affecting the EU’s financial interests that we identify in the course of our audit work (including performance audits) or on the basis of information provided to us directly by third parties. OLAF then follows up on these cases, decides whether to launch an administrative investigation and cooperates as necessary with Member State authorities and the EPPO.

1.50. The European Public Prosecutor’s Office (EPPO), established in 2017, is an independent EU body with powers to investigate, prosecute and bring to judgment crimes against the EU budget, such as fraud, corruption or serious cross-border VAT fraud, as defined in the PIF Directive and the Council Regulation (EU) 2017/1939. We have been cooperating with the EPPO since it started operations in June 2021, and our two organisations signed a working arrangement on 3 September 2021. We forward to the EPPO any suspicions, arising either from our audit work or from information reported to us, of criminal offences falling within its competence. The EPPO then follows up on these cases and decides whether to open a criminal investigation.

---


34 Council Regulation (EU) 2017/1939 implementing enhanced cooperation on the establishment of the European Public Prosecutor’s Office (the ‘EPPO’).

March 2022, we decided to start forwarding cases of suspected fraud to both OLAF and the EPPO simultaneously where appropriate.

1.51. We reported to OLAF 15 cases (2020: six cases) of suspected fraud that we had identified in the course of our audit work in 2021, from which OLAF has already opened five investigations. We reported one of these cases in parallel to the EPPO, along with an additional case that we had identified in the course of our audit work in 2021.

1.52. The most frequently suspected fraudulent or criminal acts were: artificial creation of conditions necessary for EU financing, occasionally involving falsification of official documents; use of grants for unauthorised purposes; declaration of costs not meeting eligibility criteria, and procurement irregularities. Based on information arising from our audit work between 2011 and 2021, OLAF recommended the recovery of a total of €537 million relating to 43 cases36.

1.53. In addition to our reporting in this chapter on cases forwarded to OLAF and the EPPO we also report in chapter 5 on how audit authorities address the risk of fraud (see paragraph 5.49), and in chapter 6 on our follow-up of the recommendation to address weaknesses in CAP anti-fraud policies and procedures (see paragraph 6.49). In addition, we cover fraud in separate audits. We have completed our audit on Commission action to combat fraud in common agricultural policy (CAP) spending37 and on the use of blacklisting to protect the EU budget from untrustworthy counterparties38. We are currently conducting audits on conflict of interest in shared management (the CAP and cohesion policy). In addition, we cover specific fraud-related risks in our audits on the Commission’s and Member States’ control systems for the RRF.

36 The information is provided by OLAF and is not examined by us.

37 Special report 14/2022 “The Commission’s response to fraud in the Common Agricultural Policy: Time to dig deeper”.

38 Special report 11/2022 “Protecting the EU budget: Better use of blacklisting needed”.
Conclusions

1.54. The key function of this chapter is to support the audit opinion presented in the statement of assurance. We present the related audit results in paragraphs 1.55 and 1.56.

Audit results

1.55. We conclude that the accounts were not affected by material misstatements.

1.56. As for the regularity of transactions, we conclude that revenue was free from material error. For expenditure, our audit results show that the estimated level of error has increased compared to last year, from 2.7 % to 3.0 %. High-risk (mainly reimbursement-based) expenditure was affected by a material level of error. This year, the proportion of high-risk expenditure in our audit population further increased to 63.2 %, and it continues to represent a substantial part of our audit population.

1.57. The Commission’s estimate of error (risk at payment), as disclosed in the 2021 AMPR, is 1.9 %, which is below our range.

1.58. Limitations in the Commission’s and Member States’ ex post checks in MFF headings 1, 2 and 6 affect the risk at payment disclosed in the AMPR and hence the Commission’s risk assessment. Our follow-up of the Commission’s reporting on financial corrections and recoveries shows that it has improved, but that the presentation could lead to misunderstanding.
Annexes

Annex 1.1 – Audit approach and methodology

(1) This annex outlines our approach and methodology for auditing the reliability of accounts and the regularity of revenue and MFF\(^{39}\) (budget spending) transactions. Our audit approach for expenditure under the RRF\(^{40}\) (the main component of NGEU\(^{41}\)), which is different and temporary, is outlined in chapter 10.

(2) Our work conforms to the international standards on auditing and ensures that our audit opinions are supported by sufficient and appropriate audit evidence. This annex also refers to the main differences between our audit approach and the way the Commission estimates and reports on the level of irregularities\(^{42}\), while exercising its duties as manager of the EU budget. To this end, we clarify how we:

- extrapolate the errors found (paragraph (7));
- structure our chapters around MFF headings (paragraph (9));
- apply EU and national rules (paragraph (10)) and
- quantify procurement errors (paragraph (19)).

(3) Our audit methodology is available on our website\(^{43}\). We use an assurance model to plan our work. In our planning, we consider the risk of errors occurring (inherent risk) and the risk of errors not being prevented or detected and corrected (control risk).

---

\(^{39}\) Council Regulation (EU, Euratom) 2020/2093 laying down the MFF for the years 2021 to 2027.


\(^{41}\) Council Regulation (EU, Euratom) 2020/2094.


\(^{43}\) ECA audit methodology platform AWARE.
PART 1 – Audit approach for the reliability of accounts

(4) We examine the EU’s consolidated accounts to determine their reliability. These consist of:

(a) the consolidated financial statements; and
(b) the budgetary implementation reports.

(5) The consolidated accounts should properly present, in all material respects:

(a) the financial position of the European Union at year end;
(b) the results of its operations and cash flows; and
(c) the changes in net assets for the year ended.

(6) In our audit, we:

(a) evaluate the accounting control environment
(b) check the functioning of key accounting procedures and the year-end closure process;
(c) analyse the main accounting data for consistency and reasonableness;
(d) analyse and reconcile accounts and/or balances;
(e) perform substantive tests of commitments, payments and specific balance sheet items, based on representative samples;
(f) use the work of other auditors where possible, in accordance with international standards on auditing, particularly when auditing borrowing and lending activities managed by the Commission for which external audit certificates are available.
(g) use the level of 2.0 % as the materiality threshold for our opinion. We also take account of the nature, amount and context of errors and other information available.

PART 2 – Audit approach for the regularity of transactions

(7) Our current approach for assessing whether the transactions underlying the accounts comply with EU rules and regulations is to rely mainly on direct testing of compliance for a large, random, representative sample of transactions. According to accepted statistical practices, extrapolation of the results of a
statistical sample provides the best estimate for the error rate. We divide our sample into high-risk and low-risk expenditure and different strata for the MFF headings on which we report. This procedure allows us to extrapolate the errors we detect to the areas concerned.

(8) However, we consider whether we can make efficient use of the checks on regularity already performed by other auditors. If we want to use the results of these checks in our audit work, in line with audit standards, we assess the independence and competence of the other auditors and the scope and adequacy of their work.

How we test transactions

(9) We organise our audit work and report its results around the various MFF headings in line with the budget structure decided by the legislator. Under each MFF heading where we provide a specific assessment (chapters 4-6 and 9), we test a representative sample of transactions in order to provide an estimate of the level of error in the overall audit population.

(10) For each selected transaction, we determine whether or not the claim or payment was made for the purpose approved in the budget and specified in legislation and was in compliance with applicable laws and regulations. Our assessment takes due account of the interpretation of EU and national law provided by national judicial courts or national independent and authoritative bodies and the European Court of Justice. We examine how the amount of the claim or payment was calculated (for larger claims: based on a selection representative of all items in the transaction). This involves tracing the transaction from the budgetary accounts to the final recipient (e.g. a farmer, or the organiser of a training course or development aid project), testing compliance at each level.

(11) When testing revenue transactions, our examination of value added tax and GNI-based own resources takes as a starting point the macroeconomic aggregates based on which these are calculated. For the own resource based on non-recycled plastic packaging waste, we reviewed the process for compiling forecast data, as Member States will only provide their statistical estimates for the current year in 2023. We examine the Commission’s controls on these Member State contributions up to the point they were received and recorded in the consolidated accounts. For traditional own resources, we examine the customs authorities’ accounts and the flow of duties — again up to the point they were received and recorded by the Commission.
On the expenditure side, we examine expenditure at the point when final recipients of EU funds have undertaken activities or incurred costs, and when the Commission has accepted the expenditure ('accepted expenditure'). This applies to all categories of payments (including those made to purchase assets). In practice, this means that our population of transactions covers interim and final payments. We did not examine pre-financing payments at the point they were made, but rather once:

(a) the final recipient of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) has provided evidence of their use; and

(b) the Commission (or other institution or body managing EU funds) has accepted the final use of the funds by clearing the advance.

Changes to the previous 2014–2020 MFF legislation for 'Cohesion' had an impact on what the Commission considers 'accepted expenditure' in this area. Since 2017, our audit population for this MFF heading has consisted, for the 2014–2020 period, of expenditure included in the accounts accepted annually by the Commission and, for the 2007–2013 period, of final payments (including pre-financing already cleared). This means we tested transactions for which Member States should have implemented all relevant actions to correct errors that they themselves had identified. Our objective is, in addition to contributing to the 2021 statement of assurance, to review the work of audit authorities and conclude on the reliability of the Commission’s key regularity indicator for this area – the residual error rate.

Our audit sample is designed to provide an estimate of the level of error for the expenditure as a whole rather than for individual transactions (e.g. a particular project). We use monetary unit sampling to select claims or payments and, at a lower level, individual items within a transaction (e.g. project invoices, parcels in a claim by a farmer). The error rates reported for these items should not be seen as a conclusion on their respective transactions, but rather contribute directly to the overall level of error for EU expenditure as a whole.

We do not examine transactions in every Member State, beneficiary state and region in any given year. While we may name certain Member States, beneficiary states and/or regions, this does not mean that the examples do not occur elsewhere. The illustrative examples presented in this report do not form a basis for conclusions to be drawn on the specific Member States, beneficiary states and/or regions concerned.
Our approach is not designed to gather data on the frequency of error in the whole population. Therefore, figures presented on the number of errors detected in an MFF heading, in expenditure managed by a DG or in spending in a particular Member State are not an indication of the frequency of error in EU-funded transactions or in individual Member States.

**How we evaluate and present the results of transaction testing**

An error may concern all or part of the amount involved in an individual transaction. We consider whether errors are quantifiable or non-quantifiable, i.e. whether or not it is possible to measure how much of the amount examined was affected by the error. Errors detected and corrected prior to and independently of our checks are excluded from the calculation and frequency of error, since their detection and correction demonstrate that the control systems have worked effectively.

Our criteria for the quantification of public procurement errors are described in the document 'Non-compliance with the rules on public procurement – types of irregularities and basis for quantification'.

Our quantification may differ from that used by the Commission or Member States when deciding how to respond to the misapplication of the public procurement rules. We quantify only serious breaches of procurement rules. We quantify as 100 % procurement errors only those infringements that have prevented the best bid from winning the tender, rendering expenditure under this contract ineligible. We do not use flat rates for the different types of infringement of procurement rules as the Commission does. We base our quantification of public procurement errors on the amounts of ineligible expenditure in examined transactions.

**Estimated level of error**

For most MFF headings and for the overall EU budget, we present an 'estimated level of error' (ELE), which takes account of quantifiable errors only and is expressed as a percentage. Examples of errors are quantifiable breaches of

---

44 Quantification of public procurement errors.

45 Commission’s 2019 guidelines on financial corrections in case of public procurement irregularities in the annex to the Commission decision of 14.5.2019 laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on public procurement.
applicable regulations, rules or contract or grant conditions. We also estimate the lower error limit (LEL) and the upper error limit (UEL).

(21) We use the level of 2.0% as materiality threshold for our opinion. We also take account of the nature, amount and context of errors and other information available.

(22) We no longer base our statement of assurance solely on our overall estimate of error. Since 2016, we have continued to identify low-risk areas of the EU budget, where we expect to find a non-material level of error in accepted expenditure, and high-risk areas, where we assume there will be a material level of error. For this purpose, we consider, in addition to inherent and control risks, our assessment of management and control systems together with past audit results. For example, we treat some entitlement-based rural development expenditure under MFF heading 3 and other administrative expenditure (i.e. non-salary expenditure) under MFF heading 7 as high-risk based on our past audit experience. This split enables us to determine as efficiently as possible whether material errors found are 'pervasive' (see paragraph (27)).

We examine systems and report the results

(23) The Commission, other EU institutions and bodies, Member State authorities, beneficiary countries and regions establish control systems for managing the risks to the budget and overseeing/ensuring the regularity of transactions. It is helpful to examine these systems in order to identify areas for improvement. Furthermore, the results of this work contribute to our risk assessment.

(24) Each MFF heading, including revenue, involves many individual systems. We present the results of our systems work together with recommendations for improvement.

How we arrive at our opinions in the statement of assurance

(25) We base our opinion on sufficient, relevant and reliable audit evidence on the regularity of transactions underlying the EU’s consolidated accounts. To obtain this evidence, we carry out transaction testing and examination of management and control systems, which is reported on in chapters 3-9. This work allows us to arrive at an informed opinion as to whether errors in the population exceed or fall within the materiality limits.

(26) Where we find a material level of error and determine its impact on the audit opinion, we must determine whether or not the errors, or the absence of audit evidence, are 'pervasive'. In doing so, we apply the guidance contained in
International Standard on Auditing (ISA) 705 (revised) \(^{46}\) (extending this guidance to apply to issues of legality and regularity, in accordance with our mandate). Where errors are material and pervasive, we present an adverse opinion.

(27) An error and/or absence of audit evidence are 'pervasive' if, in the auditor’s judgment, they are not confined to specific elements, accounts or items in the financial statements (i.e. they occur throughout the accounts or transactions tested). Even if they are so confined, they are still pervasive if they represent, or could represent, a substantial proportion of the financial statements, or relate to disclosures which are fundamental to users’ understanding of the financial statements.

PART 3 – Audit procedures in relation to fraud

(28) We identify and assess the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of EU law, whether due to fraud or error.

(29) We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

(30) If we have reason to suspect that fraudulent activity has taken place, we report this to OLAF, the EU’s anti-fraud office. OLAF is responsible for carrying out any resulting administrative investigations. In addition, since 2021, we have forwarded to the European Public Prosecutor’s Office (EPPO) any suspicions, arising from our audit work or from information reported to us, of criminal offences falling within its competence. The EPPO then follows up on these cases and decides whether to open a criminal investigation. We report several cases per year to OLAF and the EPPO.

\(^{46}\) International Standard on Auditing (ISA) 705 (revised) - Modifications to the Opinion in the Independent Auditor’s Report.
PART 4 — Link between the audit opinions on the reliability of accounts and on the regularity of transactions

(31) We have issued:

(a) an audit opinion on the consolidated accounts of the EU for the financial year ended; and

(b) audit opinions on the regularity of the revenue and expenditure underlying those accounts.

(32) Our work and our opinions follow the IFAC’s International Standards on Auditing and Codes of Ethics and INTOSAI’s International Standards of Supreme Audit Institutions.

(33) Where auditors issue audit opinions on both the reliability of accounts and the regularity of transactions underlying those accounts, these standards state that a modified opinion on the regularity of transactions does not, in itself, lead to a modified opinion on the reliability of accounts.
Chapter 2

Budgetary and financial management
Introduction

Budgetary and financial management in 2021

Budget implementation was low for commitments but high for payments

The late adoption of regulations resulted in low implementation of commitment appropriations

Almost all payment appropriations were used

The absorption of 2014-2020 ESIF funding increased

The amount of budgetary transfers increased

Implementation of NGEU began in 2021

There were significant differences in the extent of implementation of commitments between programmes with NGEU funding

Many Member States received pre-financing of RRF grants, and Spain received a payment for reaching milestones

Outstanding commitments from the EU budget and NGEU reached a record amount of €341.6 billion

Payments to final recipients of financial instruments under shared management finally picked up in 2020

Off-budget external action instruments are now incorporated into the EU budget

There is still no comprehensive COVID-19 reporting
Risks and challenges  

Implementing various budgetary instruments in parallel in a relatively short period of time involves risks and challenges  

The total exposure of the EU budget increased in 2021, mainly due to the introduction of NGEU  

There are a number of mechanisms to protect the EU budget from risks associated with contingent liabilities  

The headroom of the own resources ceiling was increased  

Counter-guarantees for SURE loans reduce risks borne by EU budget  

The Common Provisioning Fund started to pull together guarantee funds in 2021  

Russia’s war of aggression against Ukraine increases risks to the EU budget  

Conclusions and recommendations  

Conclusions  

Recommendations  

Annexes  

Annex 2.1 – NGEU implementation by programme (in million euros)
Introduction

2.1. This chapter presents the main budgetary and financial management issues we identified in our work for 2021, the first year of the new 2021-2027 multiannual financial framework (MFF). Our analysis also covers the additional financing arising from the NextGenerationEU (NGEU) instrument, which is aimed at supporting the recovery in the aftermath of the COVID-19 pandemic. In this chapter, we also report on budgetary and financial risks and challenges that the EU may face in future years. The chapter is based on our review of the implementation of the EU budget and of documents published by the Commission and other stakeholders. It also takes account of the work done for our annual report, special reports, reviews and opinions.

---

1 Council Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027.

Budgetary and financial management in 2021

Budget implementation was low for commitments but high for payments

2.2. In this section, we analyse how the EU budget was implemented in 2021. Expenditure funded by carry-overs and assigned revenue are excluded from this analysis because they are not part of the adopted budget and subject to different rules. Our analysis also covers the additional amounts stemming from the NGEU instrument. Coverage of the Recovery and Resilience Facility (RRF) is limited to the grant-based component and excludes the loan-based component, which is kept separate from the EU budget.

2.3. The EU’s 2021 adopted budget had more payment appropriations than commitment appropriations. This is the first time that this has happened for the last 40 years. In the past, we have called for an orderly balance to be maintained between payment and commitment appropriations, and for sufficient payment appropriations to be made available.

The late adoption of regulations resulted in low implementation of commitment appropriations

2.4. The budgetary authority approved an initial budget of €164.3 billion for commitment appropriations as well as six amending budgets, four of which changed the amount of commitment appropriations. The final budget for commitment appropriations was €166.8 billion, which is above the MFF ceiling of €163.5 billion (see Figure 2.1). This was made possible by the deployment of special instruments, such as the Flexibility Instrument and the Solidarity and Emergency Aid Reserve, which the EU can use to react flexibly to unforeseen circumstances.

---

3 See paragraph 2.48 of our 2016 annual report, paragraph 2.48 of our 2018 annual report, and paragraph 2.52 of our 2019 annual report.
2.5. During 2021, a total of €113.4 billion was committed: only 68 % of the total amount available. This rate is exceptionally low, even lower than in 2014, the first year of the previous MFF (77 %).

2.6. The legislative package underpinning the 2021-2027 MFF consists of the MFF Regulation\(^4\), which was initially proposed by the Commission in May 2018 and only adopted in December 2020, and a series of sectoral regulations, which were all approved after the start of the MFF. For the agricultural funds\(^5\), a transition period was adopted for 2021-2022. The delay in adopting sectoral legislation was significantly greater than at the start of the 2014-2020 MFF. The delays were largely the result of the COVID-19 pandemic, and of the second Commission proposal for the MFF, which was issued in May 2020.

2.7. In our 2020 annual report\(^6\), we highlighted the risk that the implementation of shared-management funds under the 2021-2027 MFF might be delayed due to the late adoption of the Common Provisions Regulation (CPR)\(^7\). We also highlighted the risk of pressure on the Commission’s and the Member States’ administrative resources due to the need to speed up the absorption of funding from the European Structural Investment Funds (ESIF) under the 2014-2020 MFF and the additional availability of financing (NGEU).

---


\(^5\) Regulation (EU) 2020/2220 laying down certain transitional provisions for support from the European Agricultural Fund for Rural Development (EAFRD) and from the European Agricultural Guarantee Fund (EAGF) in the years 2021 and 2022.

\(^6\) See our 2020 annual report, paragraphs 2.23-2.31.

\(^7\) Regulation (EU, Euratom) 2021/1060 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.
2.8. In 2021, delays in the adoption of the sectoral regulations slowed down the launch of new programmes, particularly for the eight shared management funds under the CPR. Only 2% of the available amount of commitment appropriations for these eight shared management funds was used. The use of commitment appropriations for the three biggest funds (the European Regional Development Fund, the Cohesion Fund and the European Social Fund) was less than 1%. This expenditure was associated with items such as technical assistance. As a result, according to the provisions of the MFF Regulation, almost €49 billion of an available total of €50.1 billion of the commitment appropriations of the shared-management funds need to be transferred from 2021 to the 2022-2025 financial years in equal proportions (25%). The related payments to Member States will therefore be made later than originally planned.

Almost all payment appropriations were used

2.9. For payment appropriations, the budgetary authority approved an initial budget of €166.1 billion, which was almost identical to the ceiling set by the MFF Regulation for 2021. Two amending budgets increased the available amount of payment appropriations by €2.0 billion, making the final budget €168.0 billion. As was the case with commitment appropriations, this exceeding of the MFF ceiling was made possible by the use of special instruments. Almost all available payment appropriations in the EU budget were used. Payments reached €163.6 billion, 97% of total available appropriations. See Figure 2.1. Of the total value of payments made in 2021, 46% was used to cover the needs of the 2014-2020 ESIF.

8 The eight shared management funds under the CPR are the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund, the European Maritime, Fisheries and Aquaculture Fund, the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.


10 The difference is due to rounding.
2.10. Taking into account additional payments of €62.6 billion from assigned revenue (mainly RRF grants) and €1.8 billion of carry-overs from 2020, payments in 2021 totalled €228.0 billion.

2.11. Payments in 2021 were well within the limits of the payment ceiling. There was no demand for payments from the new shared-management funds, and enough payment appropriations were available to meet the remaining high levels of payment demands from the 2014-2020 ESIF. According to the Commission’s long-term forecast\(^{11}\), the MFF should have sufficient payment appropriations to cover payment needs in future years.

\(^{11}\) Commission report on long-term forecast of future inflows and outflows of the EU budget 2021-2027, COM(2021) 343 final.
The absorption of 2014-2020 ESIF funding increased

2.12. As described in paragraphs 2.6-2.8, the implementation of shared-management funds under the CPR in the 2021-2027 MFF did not start as planned. Almost no payments were made for them in 2021.

2.13. During 2021, the Member States continued to absorb ESIF funding from the 2014-2020 MFF period. Furthermore, for 2021 and 2022, the European Agricultural Fund for Rural Development (EAFRD) received additional allocations from the 2021-2027 MFF (€28.1 billion).

2.14. At the end of 2021, total cumulative payments for the 2014-2020 ESIF operational programmes amounted to €331.1 billion, from a total of €492 billion (67%). The remaining €160.9 billion should be paid out, and the remainder decommitted by the closure of the programmes before the end of 2025, except for the EAFRD, for which closure will take place in 2027. This amount makes up most of the EU budget’s €251.7 billion of outstanding commitments at the end of 2021 (see paragraph 2.26). In 2021, annual absorption was greater than in previous years. Payments increased from €72 billion in 2020 to €75.1 billion in 2021 (excluding NGEU). In Figure 2.2, we present the cumulative absorption rates for each ESI Fund excluding NGEU resources.
Figure 2.2 – Absorption of ESIF funding 2014-2020 (excluding NGEU resources)

Acronyms: European Regional Development Fund (ERDF), European Agricultural Fund for Rural Development (EAFRD), European Social Fund (ESF), Cohesion Fund (CF), Youth Employment Initiative (YEI), European Maritime and Fisheries Fund (EMFF) and Fund for European Aid to the Most Deprived (FEAD).

(*) The red line denotes the absorption rate without the additional 2021 and 2022 allocations of €28.1 billion from the 2021-2027 MFF.
(**) YEI includes ESF matching component.

Source: ECA, based on data from the Commission ESIF 2014-2020 EU payments (daily update)

2.15. Apart from the European Maritime and Fisheries Fund (EMFF), the absorption percentages are within 10 percentage points of each other across all ESI Funds. This includes the EAFRD, which would have had an absorption rate of 79% instead of 62% if the additional allocation of resources described in paragraph 2.13 had been excluded.

2.16. As Figure 2.3 shows, the Member States’ cumulative absorption of ESIF funding varies significantly. Ireland, Finland, Cyprus and Estonia (in descending order of absorption) have received more than 75% of the amounts allocated to them (excluding NGEU). Croatia, Slovakia, Malta, Denmark and Romania (in ascending order of absorption), on the other hand, have received less than 60% of their committed
amounts. Taking into account the approaching closure of the programmes, the pressure to absorb all the funds to avoid *decommitments* is particularly significant for certain Member States.

**Figure 2.3 – 2014-2020 ESIF absorption levels (excluding NGEU resources)**

<table>
<thead>
<tr>
<th></th>
<th>Million euros remaining to be absorbed</th>
<th>Percentage remaining to be absorbed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Croatia</td>
<td>5 187</td>
<td>54%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>6 794</td>
<td>57%</td>
</tr>
<tr>
<td>Malta</td>
<td>375</td>
<td>57%</td>
</tr>
<tr>
<td>Denmark</td>
<td>752</td>
<td>58%</td>
</tr>
<tr>
<td>Romania</td>
<td>13 584</td>
<td>59%</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>4 252</td>
<td>60%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>882</td>
<td>61%</td>
</tr>
<tr>
<td>Belgium</td>
<td>1 161</td>
<td>61%</td>
</tr>
<tr>
<td>Spain</td>
<td>16 367</td>
<td>62%</td>
</tr>
<tr>
<td>Italy</td>
<td>18 326</td>
<td>62%</td>
</tr>
<tr>
<td>Germany</td>
<td>11 726</td>
<td>62%</td>
</tr>
<tr>
<td>Multi-country</td>
<td>3 506</td>
<td>63%</td>
</tr>
<tr>
<td>France</td>
<td>10 857</td>
<td>66%</td>
</tr>
<tr>
<td><strong>Total EU</strong></td>
<td><strong>160 905</strong></td>
<td><strong>67%</strong></td>
</tr>
</tbody>
</table>

|                |                                        |                                    |
| Sweden         | 1 328                                  | 68%                                 |
| United Kingdom | 5 184                                  | 68%                                 |
| Latvia         | 1 875                                  | 68%                                 |
| Austria        | 1 843                                  | 70%                                 |
| Slovenia       | 1 223                                  | 71%                                 |
| Greece         | 6 335                                  | 73%                                 |
| Hungary        | 7 078                                  | 73%                                 |
| Czech Republic | 6 659                                  | 73%                                 |
| Poland         | 23 360                                 | 74%                                 |
| Lithuania      | 2 342                                  | 74%                                 |
| Luxembourg     | 44                                     | 74%                                 |
| Portugal       | 6 798                                  | 75%                                 |
| Estonia        | 1 117                                  | 76%                                 |
| Cyprus         | 233                                    | 76%                                 |
| Finland        | 962                                    | 79%                                 |
| Ireland        | 754                                    | 81%                                 |

*Note: The figures include the additional allocation of resources for the EAFRD.*

*Source: ECA, based on data from the Commission ESIF 2014-2020 EU payments (daily update).*
The amount of budgetary transfers increased

2.17. The *Financial Regulation*\textsuperscript{12} defines the rules for making budgetary transfers, which depend on the EU budget structure. Some transfers of appropriations between budget lines require a decision by the budgetary authority. Other transfers can be made autonomously by the EU institution concerned.

2.18. There is a new budget structure for the 2021-2027 MFF, which has resulted in a better mapping of programmes in the budget. The MFF headings are now composed of specific policy clusters and each programme belongs to one policy cluster. This new budgetary structure enables the Commission to transfer appropriations within a programme without first obtaining a decision by the budgetary authority, even if aspects of the programme are managed by different DGs. The European Parliament has raised concerns about ensuring the budgetary authority can apply sufficient scrutiny to transfers within programmes under the new structure\textsuperscript{13}.

2.19. We compared the value of transfers in 2020 and 2021 by the Commission and noted that the amounts of transfers increased, particularly those of payment appropriations. See *Figure 2.4*. We noted also that at the same time the transfers requiring a decision by the budgetary authority rose as well.

\textsuperscript{12} Articles 30 to 32 of *Regulation (EU, Euratom) 2018/1046* on the financial rules applicable to the general budget of the Union.

\textsuperscript{13} Point 41 of 2021/2162(INI).
Implementation of NGEU began in 2021

There were significant differences in the extent of implementation of commitments between programmes with NGEU funding

2.20. The temporary NGEU instrument started in June 2021 with the entry into force of the new Own Resources Decision\(^{14}\) authorising the related borrowing. The Commission can commit funds under NGEU until 31 December 2023, and can make payments until 31 December 2026.

2.21. NGEU comprises:

— the grant-based component of the RRF, which is non-repayable support to Member States of up to €338.0 billion;

— additional funding for EU programmes, amounting to €83.1 billion; and

---

\(^{14}\) Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.
— the loan-based component of the RRF, which is repayable support to Member States and not part of our analysis.

2.22. By the end of 2021, commitments of NGEU funds reached €143.5 billion. Pre-financing and payments were more than €53.6 billion. See Figure 2.5 and Annex 2.1 for more information.

Figure 2.5 – NGEU implementation

RRF grants

<table>
<thead>
<tr>
<th>Grant</th>
<th>Commitments made in 2021</th>
<th>Payments made in 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recovery and Resilience Facility (RRF)</td>
<td>46.4</td>
<td>98.0</td>
</tr>
<tr>
<td>(incl. Technical Support Instrument)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NGEU top-up of EU programmes

<table>
<thead>
<tr>
<th>EU Programme</th>
<th>Commitments made in 2021</th>
<th>Payments made in 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Regional Development Fund (ERDF)*</td>
<td>4.9</td>
<td>24.0</td>
</tr>
<tr>
<td>European Social Fund (ESF)**</td>
<td>2.1</td>
<td>19.2</td>
</tr>
<tr>
<td>Just Transition Fund</td>
<td>0.0</td>
<td>10.9</td>
</tr>
<tr>
<td>European Agricultural Fund for Rural Development (EAFRD)</td>
<td>2.4</td>
<td>8.1</td>
</tr>
<tr>
<td>Invest EU Fund</td>
<td>1.7</td>
<td>6.1</td>
</tr>
<tr>
<td>Horizon Europe</td>
<td>1.8</td>
<td>5.4</td>
</tr>
<tr>
<td>Union Civil Protection Mechanism (RescEU)</td>
<td>2.1</td>
<td>2.1</td>
</tr>
</tbody>
</table>

(*) Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) funding.
(**) REACT-EU funding for European Social Fund and Fund for European Aid to the most deprived (see paragraph 2.13).

Note: The amounts are rounded.

Source: ECA, based on data from the consolidated annual accounts of the EU for 2021 and budgetary implementation reports from the Commission’s accounting system.
2.23. The speed at which different programmes committed NGEU funds varied significantly. For example, the ERDF, the European Social Fund (ESF) and the FEAD committed a high amount of NGEU funding for their existing programmes under the 2014-2020 MFF, compared to the low use of commitments for the Just Transition Fund\(^{15}\) and the Union Civil Protection Mechanism (rescEU)\(^{16}\). According to the Commission, the Just Transition Fund’s slow start was caused by delays in adopting the corresponding regulation. In the case of rescEU, the delays were mainly caused by the need to clarify the scope of the instrument. The time needed to involve the newly created European Health Emergency preparedness and Response Authority (HERA)\(^{17}\) also contributed to the delays.

Many Member States received pre-financing of RRF grants, and Spain received a payment for reaching milestones

2.24. To receive RRF support, Member States had to submit their national recovery and resilience plans (NRRPs) to the Commission. The Commission assesses the plans and the Council approves them. By the end of 2021, the Council had approved 22 NRRPs and 20 Member States had collectively received €36.4 billion of pre-financing (up to 13 % of their total allocated grants).

2.25. The remaining amounts will be paid based on the fulfilment of the milestones and targets set out in the Council implementing decision referred to in Article 20(1) of the RRF Regulation\(^{18}\). In 2021, one Member State, Spain, received such a payment (€10.0 billion). Figure 2.6 shows the 2021 disbursements and the remaining RRF allocations for the Member States with approved NRRPs.

---

15 Regulation (EU) 2021/1056 establishing the Just Transition Fund.

16 Decision (EU) 2019/420 on a Union Civil Protection Mechanism.

17 Commission communication introducing HERA, the European Health Emergency preparedness and Response Authority, the next step towards completing the European Health Union, COM(2021) 576 final.

### Outstanding commitments from the EU budget and NGEU reached a record amount of €341.6 billion

#### 2.26

Outstanding commitments at the end of 2021 totalled €341.6 billion; €251.7 billion related to the EU budget and €89.9 billion to NGEU. The EU budget’s outstanding commitments decreased significantly from a historic high of €303.2 billion at the end of 2020, mainly due to delays to the start of the implementation of shared-management funds under the 2021-2027 MFF (see paragraphs 2.6-2.8).
2.27. *Figure 2.7* shows total outstanding commitments from both the EU budget and NGEU at the end of 2021, broken down by year of origin.

**Figure 2.7 – Outstanding commitments as at the end of 2021 by year of origin**

Source: ECA, based on data from the consolidated annual accounts of the EU for 2021 and budgetary implementation reports from the Commission’s accounting system.

2.28. As *Figure 2.8* shows, the common agricultural policy (CAP) (Heading 3) and cohesion policy (Heading 2a) together represent 64% of outstanding commitments from the EU budget at the end of 2021. According to the Commission\(^{19}\), implementation of both the CAP and cohesion policy may also be affected by the additional availability of NGEU financing, in addition to delays resulting from the late adoption of the relevant legislation, largely due to the COVID-19 pandemic.

\(^{19}\) COM(2021) 343 final, pp. 5, 6.
Figure 2.8 – Outstanding commitments from the EU budget and NGEU by MFF Headings as at the end of 2021

(billion euros)

Notes:
Heading 2b includes RRF outstanding commitments.
Heading 7 does not show due to the low amount of outstanding commitments.

Source: ECA, based on data from the consolidated annual accounts of the EU for 2021.

2.29. We noted last year\textsuperscript{20} that the substantial increase in outstanding commitments of the EU budget from 2014 to 2020 was caused by commitments each year being significantly higher than payments. This added €105.9 billion in outstanding commitments during the period, which was offset by decommitments worth €25.1 billion to give a net increase of €80.8 billion (from €222.4 billion to €303.2 billion). It is worth noting that in 2014-2020, the total amount decommitted was only a small proportion (2.3 \%) of the total amount committed (€1 081.7 billion) for the same period.

\textsuperscript{20} See our 2020 annual report, paragraph 2.10.
2.30. Based on the Commission’s latest available estimates (2021), we would expect combined (EU budget and NGEU) outstanding commitments to increase to €460 billion in 2023 (see Figure 2.9), after which time they are set to decrease again. NGEU payments are due to be completed by the end of 2026, at which point no further outstanding commitments from NGEU should remain. Russia’s war of aggression against Ukraine, which started on 24 February 2022, has created uncertainties that are not taken into account in these estimates (see paragraph 2.52).

Figure 2.9 – Development of outstanding commitments, commitments and payments for 2014 to 2021 and forecast for 2022 to 2027

![Graph showing the development of outstanding commitments, commitments, and payments from 2014 to 2027.]


2.31. The Commission forecasts that outstanding commitments from the EU budget will reach €317 billion in 2027, €14 billion higher than the €303.2 billion at the end of 2020. This small increase is mainly due to the smaller gap between commitment and payment appropriations in the 2021-2027 MFF. On several occasions, we have

---

21 See our 2018 annual report, paragraphs 2.18-2.21, our 2017 annual report, paragraphs 2.46-2.49 and our 2016 annual report, paragraphs 2.32-2.39.
pointed out that outstanding commitments can be reduced if budgeted payment appropriations exceed commitment appropriations and are used. In our view, this would be in line with the requirement, laid down in the Own Resources Decision, to maintain an orderly ratio between appropriations for commitments and payments\textsuperscript{22}.

2.32. The European Parliament has pointed out that the amount of outstanding commitments equals two full years of payment appropriations. According to the Parliament, this poses a risk to the smooth operation of the EU budget in the future, putting it under serious pressure and potentially threatening its liquidity\textsuperscript{23}. It has asked the Commission, as a matter of priority, to prepare a detailed plan of actions to reduce outstanding commitments and present it to the discharge authority.

Payments to final recipients of financial instruments under shared management finally picked up in 2020

2.33. Financial instruments under shared management (FISMs) provide financial support from the EU budget to final recipients in the form of loans, guarantees and equity investments. During 2007-2013, the committed amount of FISMs was €17.0 billion\textsuperscript{24}, and during 2014-2020, the amount was €21.6 billion\textsuperscript{25}.

2.34. The Commission’s report on the implementation of the FISMs shows that for the 2014-2020 MFF, the amount actually paid from the EU budget to the FISMs was €14.2 billion at the end of 2020. After a low level of payments to final recipients from 2014 to 2019, the amount of payments increased rapidly in 2020, bringing the total amount of payments made to final recipients to €10.3 billion by the end of 2020. However, this still only represents 47 % of the total amount committed to the instruments (see Figure 2.10).

\textsuperscript{22} Article 3.3 of Council Decision (EU, Euratom) 2020/2053.

\textsuperscript{23} Para 9.12 of Report on discharge for the financial year 2020 (2021/2106(DEC)), 11 April 2022.


\textsuperscript{25} Commission report Financial instruments under the European Structural and Investment Funds, situation as at 31 December 2020, page 8.
2.35. We analysed Commission data on the FISMs and found significant differences in implementation between Member States. By the end of 2020, two Member States had paid more than 70 % of the committed amounts to final recipients (Finland and Austria), while in five other Member States the level of payments to final recipients remained below 30 % (Slovenia, Estonia, Portugal, Bulgaria and Cyprus) (see Figure 2.11).

Note: Information for 2015 concerns 2014 and 2015 cumulatively.

---

Our analyses on implementation and on management costs include only FISMs under the ERDF and the CF, which comprise together 95 % of the total committed amounts.
2.36. We also looked at the paid management costs at Member State level in proportion to the total payments including national co-financing to the FISM. We found that management costs amounted to 3.6% of total payments to the FISM under the 2014-2020 MFF. However, this is an average; the actual figure varies greatly between Member States. In Sweden, for example, management costs accounted for more than 10% of total payments to FISM. In Austria and Belgium, on the other hand, FISM did not account for any management costs (see Figure 2.12). The Commission has informed us that it will carry out a final verification of the eligibility of management costs upon programme closure.
Figure 2.12 – Management costs in relation to total payments to FISMs under the 2014-2020 MFF as at the end of 2020

Note: Total payments to FISMs include national co-financing.

Source: ECA, based on data received from the Commission.
Off-budget external action instruments are now incorporated into the EU budget

2.37. One of the key changes introduced to the 2021-2027 MFF was the incorporation into the EU budget, through the *Neighbourhood Development and International Cooperation Instrument (NDICI)*, of most of the actions previously financed under the European Development Funds (EDFs). The NDICI superseded 11 former instruments of the previous MFF and the EDFs\(^7\). Its commitment appropriations account for 72% of the total available for Heading 6 (‘Neighbourhood and the world’) under the 2021-2027 MFF. *Figure 2.13* gives an overview of the structure of the NDICI and a breakdown of the funds allocated to it for the 2021-2027 MFF, amounting to €79.5 billion.

---

\(^7\) The previous instruments that NDICI superseded are: the Development Cooperation Instrument (DCI), the European Development Fund (EDF), the European Instrument for Democracy and Human Rights (EIDHR), the European Neighbourhood Instrument (ENI), the Partnership Instrument (PI), the Instrument contributing to Stability and Peace (IcSP), the External Lending Mandate (ELM), Guarantee Fund for external action (GFEA), the European Fund for Sustainable Development (EFSD) and its Guarantee Fund and the Macro-Financial Assistance (MFA). For the purpose of this list, the Common Implementing Regulation (Regulation (EU) No 236/2014) is also counted as an instrument superseded by NDICI.
Figure 2.13 – NDICI’s structure and amount of commitment appropriations during the 2021-2027 MFF period

(billion euros)

<table>
<thead>
<tr>
<th>Categories of programmes and actions and their planned amounts</th>
<th>Sub-categories and their planned amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geographic programmes: 60.4</td>
<td>Neighbourhood: 19.3</td>
</tr>
<tr>
<td>Sub-Saharan Africa: 29.2</td>
<td></td>
</tr>
<tr>
<td>Asia &amp; the Pacific: 8.5</td>
<td></td>
</tr>
<tr>
<td>America &amp; the Caribbean: 3.4</td>
<td></td>
</tr>
<tr>
<td>Thematic programmes: 6.4</td>
<td>Human rights and democracy: 1.4</td>
</tr>
<tr>
<td>Civil society organisations: 1.4</td>
<td></td>
</tr>
<tr>
<td>Peace, stability &amp; conflict prevention: 0.9</td>
<td></td>
</tr>
<tr>
<td>Global challenges: 2.7</td>
<td></td>
</tr>
<tr>
<td>Rapid response actions: 3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Emerging challenges and priorities cushion: 9.5</td>
<td>9.5</td>
</tr>
</tbody>
</table>

There is still no comprehensive COVID-19 reporting

2.38. In our 2020 annual report, we recommended that the Commission should standardise the recording of EU budgetary expenditure for COVID-19-related purposes and report on it to the budgetary authority at least annually for as long as it deemed necessary. The Commission only partially accepted this recommendation and stated that it did not intend to produce further reporting on COVID-19-related expenditure from the EU budget.

2.39. In 2021, the EU continued to finance certain COVID-19-related actions under its budget. For example, Amending Budget No 1 allocated a further €216 million in commitment appropriations and €208 million in payment appropriations to the Emergency Support Instrument and the European Centre for Disease Prevention and Control to support their response to COVID-19. Amending Budget No 6 allocated a further €450 million both in commitment and payment appropriations to the NDICI to allow it to donate 200 million doses of vaccines to non-EU countries. As in 2020, the Commission did not publish a comprehensive report on COVID-19-related expenditure financed from the EU budget in 2021. We believe that the recommendation we made last year is still valid.

---


29 For example, Team Europe actions for free vaccines to other countries.
Risks and challenges

Implementing various budgetary instruments in parallel in a relatively short period of time involves risks and challenges

2.40. The implementation of most shared-management funds in 2021, the first year of the MFF, was very low due to delays (see paragraphs 2.6-2.8). Furthermore, the 2021-2027 MFF provides one year fewer for the closure of the programmes (n+2) than the previous MFF (n+3). While this shortened time may help in reducing the RAL, it may pose a substantial challenge to the implementation of the shared-management funds during the 2022-2029 period.

2.41. In addition to the implementation of the shared-management funds during the 2022-2029 period, the ESI Funds under the 2014-2020 MFF remain to be implemented until closure in 2025 (except for the EAFRD, for which closure takes place two years later), along with NGEU until 2026 and any additional measures introduced in connection with Russia’s war of aggression against Ukraine. The challenges that these simultaneous activities represent for all bodies responsible for managing and controlling these funds to ensure compliance and sound financial management, which we highlighted last year still exist and our related recommendation remains valid.

The total exposure of the EU budget increased in 2021, mainly due to the introduction of NGEU

2.42. A contingent liability is a liability that may occur in future if a specific event occurs. The total exposure of the EU budget to contingent liabilities increased by €146.0 billion (111 %) in 2021, from €131.9 billion to €277.9 billion. This was mainly due to €91.0 billion in bonds being issued to finance NGEU in 2021, and an increase of €50.2 billion in the amount of European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) loans made to Member States (see Figure 2.14).

---

30 See our 2020 annual report, paragraphs 2.27, 2.32 and 2.33.

31 Of the €91.0 billion, €18 billion has been disbursed as RRF loans, €46.4 billion as RRF grants and €7.2 billion as contributions to MFF programmes. The remaining €19.4 billion has not yet been disbursed and remains in cash and cash equivalents.
Figure 2.14 – Total exposure of the EU budget as at the end of 2021, broken down by category

Total 277.9

- Covered by:
  - the EU budget
  - the Common Provisioning Fund

- 228.8 (SURE loans)
- 47.3 (European Financial Stabilisation Mechanism loans)
- 49.1
- 89.7
- 0.8 (Others *)
- 1.0 (Others **)
- 7.5 (Macro-Financial Assistance loans)
- 20.4 (European Fund for Strategic Investments guarantee)
- 20.3 (EIB loans – External Lending Mandate)
- 91.0 (NextGenerationEU (NGEU))

(*) EIB loans – Member States €0.6 billion, Balance of Payments loans €0.2 billion, Euratom loans – Member States €0.1 billion, difference from the total is due to rounding.
(**) European Fund for Sustainable Development (EFSD) guarantee €0.5 billion, Euratom loans – non-member countries €0.3 billion and NDICI-European Fund for Sustainable Development Plus (EFSD+) €0.2 billion.

Note: Differences are due to rounding.

Source: ECA, based on data from the consolidated annual accounts of the EU for 2021, notes 4.1.1 and 4.1.2.

2.43. “Total exposure” is the total amount for which the EU budget could potentially be liable, stemming from all possible events that may occur in future years. We reviewed the Commission’s reports on the EU budget’s exposure to contingent liabilities. Our 2019 annual report analysed the nature of this exposure and the risk management mechanisms in place concluding that the total exposure was sustainable as at the end of 2019. As mentioned in paragraph 2.42, there have been two key

33 See our 2019 annual report, paragraphs 2.22-2.34.
material changes to the risk borne by the EU budget: the addition of the SURE instrument in 2020 and the addition of NGEU in 2021. In its latest report (for 2020), the Commission considered the EU budget’s level of exposure to be sustainable as at the end of 2020 with a sufficiently conservative level of confidence. This exposure is expected to rise again in 2022 and 2023, mainly due to NGEU (see Figure 2.15).

Figure 2.15 – Comparison of past and possible overall exposure of the EU budget for 2022-2023

Source: ECA, based on data from COM(2021) 676 Final and the consolidated annual accounts of the EU for 2021.

2.4. Total exposure can be broken down into annual exposure. “Annual exposure” is the maximum amount of annual payments (capital and interest) for which the EU budget would be liable in a given financial year if all payments of guaranteed loans were in default. In 2021, annual exposure was €4.4 billion. The Commission estimates annual exposure for 2022 (including exposure under the External Lending Mandate, Macro-Financial Assistance, Euratom loans to non-EU countries and financial assistance to Member States) to be at €7 billion. In case guarantees are triggered, we consider that the EU budget would be able to finance this level of annual exposure due to the sufficiency of the headroom (see paragraphs 2.45-2.46).
There are a number of mechanisms to protect the EU budget from risks associated with contingent liabilities

The headroom of the own resources ceiling was increased

2.45. In 2021, a new Own Resources Decision34 came into force to create more headroom. The available headroom is the difference between the own resources ceiling and the actual own resources collected to finance the EU budget’s planned expenditure. The own resources ceiling is the maximum amount of own resources that the EU can request from the Member States. This headroom is available for any contingent liabilities that may need to be covered by the EU budget.

2.46. The own resources ceiling increased from 1.2 % to 1.4 % of Member States’ GNI. This 0.2 % increase was mainly intended to account for the incorporation of the EDFs into the EU budget (see paragraph 2.37) and the departure of the United Kingdom from the EU (thus reducing the EU GNI base). It also provides an additional safety buffer in case of large and sudden economic shocks such as the one during the pandemic.

2.47. The own resources ceiling was further increased by 0.6 % to 2.0 % to cover NGEU liabilities until 2058. This means that if any contingent liabilities under NGEU are triggered and funds are not available in the EU budget, the funds needed to cover them can be called up from the Member States.

Counter-guarantees for SURE loans reduce risks borne by EU budget

2.48. For the SURE instrument, in addition to the guarantee provided by the EU budget, a counter-guarantee system was put in place under which all Member States are liable to cover the risk borne by the EU budget up to €25 billion. Member States contribute to the overall amount of the counter-guarantee in proportion to their relative share of the EU’s total gross national income (GNI).

34 Council decision (EU, Euratom) 2020/2053.
The Common Provisioning Fund started to pull together guarantee funds in 2021

2.49. The risk borne by the EU budget can be reduced by appropriately provisioned financial assets. The Financial Regulation\textsuperscript{35} requires a Common Provisioning Fund (CPF) and an Effective Provisioning Rate (EPR) to be set up from the beginning of the 2021-2027 MFF. If there is a default, the CPF will cover guarantee calls arising from budgetary guarantees and financial assistance to non-EU countries before the EU budget itself is called on. The aim of the CPF is to pull together all guarantee funds of the EU, except those for financial instruments, while still maintaining compartments for each one so that amounts can be linked to the individual funds. The Commission expects to improve efficiency by managing all CPF assets together\textsuperscript{36}.

2.50. Since the beginning of 2021, the Commission has gradually been transferring the assets of existing guarantee funds into the CPF. By the end of 2021, €12.3 billion of assets had been transferred. These comprise guarantee funds from the previous MFF and the new InvestEU Guarantee Fund under the 2021-2027 MFF, which started operations in 2021 (see Figure 2.16). The maximum amount envisaged for the CPF is €25 billion by the end of 2027.

\textsuperscript{35} Articles 211-214 and 258 of Regulation (EU, Euratom) 2018/1046.

Figure 2.16 – Common Provisioning Fund components as at the end of 2021

(billion euros)

Source: ECA, based on data from the consolidated annual accounts of the EU for 2021

2.51. The EPR is aimed at optimising the overall level of provisioning. For 2021 and 2022, the EPR was set to 100 % of the assets of the CPF (€12.3 billion at the end of 2021). In subsequent years, the Commission will take into account all risk parameters and see if the circumstances allow provisioning to be set at a lower rate than 100 %. The Commission anticipates\(^{37}\) that pooling will make it possible for a slightly lower level of resources to be held to cover the risks inherent in the guaranteed operations.

Russia’s war of aggression against Ukraine increases risks to the EU budget

2.52. The EU is mobilising its budget and adding additional flexibility to react to Russia’s war of aggression against Ukraine. Measures include humanitarian and emergency support for people fleeing the war, such as ‘Cohesion’s Action for Refugees

\(^{37}\) COM(2021) 88 final, p. 3.
in Europe’ (CARE)\(^{38}\) and additional liquidity for Member States to cover costs associated with the war, such as additional pre-financing from REACT-EU\(^{39}\).

2.53. Furthermore, the war risks reducing EU economic growth and increasing inflation\(^{40}\). These factors may affect the EU budget in different ways, such as increasing borrowing costs for the non-repayable support under NGEU or inflating the costs of investments, thereby increasing the pressure on the EU budget.

2.54. The war also leads to a higher risk of contingent liabilities to the EU budget being triggered. This risk arises from guarantees given to cover loans to non-EU countries. It threatens to place pressure on the EU’s risk-mitigation tools (see paragraphs 2.45-2.51). At the end of 2021, Ukraine had outstanding loans with a nominal value of €4.7 billion under the Macro-Financial Assistance and Euratom programmes. In addition, the EIB has granted loans to the value of €2.1 billion to Ukraine, loans which are supported by EU guarantees. The war may jeopardise the repayment of these loans.


\(^{39}\) COM(2022) 145 final.

\(^{40}\) OECD, Economic outlook.
Conclusions and recommendations

Conclusions

2.55. In 2021, the implementation of commitments was very low, at 68% of the total available amount. The late adoption of sectoral regulations during 2021 delayed the launch of new programmes. The implementation of commitment appropriations for shared management funds under the CPR was only 2%. Due to this, €49 billion in commitment appropriations of shared management funds have to be transferred from 2021 to the years from 2022 to 2025. In contrast, payment appropriations were almost fully used. Both commitments and payments made were under the MFF ceiling (see paragraphs 2.2-2.11).

2.56. While there were still considerable differences between the Member States, the overall ESIF absorption rate increased in 2021 due to higher payments than in 2020. At the end of 2021, around €161 billion remained to be absorbed by the closure of ESIF programmes in 2025. Some Member States still have more than 40% of their committed amounts to absorb (see paragraphs 2.12-2.16).

2.57. The new budget structure gives the Commission greater flexibility for transfers within programmes. The value of both autonomous transfers by the Commission and transfers requiring a decision by the budgetary authority increased (see paragraphs 2.17-2.19).

2.58. NGEU commitments reached nearly €144 billion, of which around €54 billion was paid to Member States. There were significant differences in how quickly the programmes financed by NGEU were implemented. Under the main component of NGEU, the RRF, 20 Member States received pre-financing for grants, and Spain received a payment for fulfilling milestones (see paragraphs 2.20-2.25).

2.59. At the end of 2021, total outstanding commitments reached a record high of €341.6 billion. The part stemming from the EU budget decreased from €303.2 billion at the end of 2020 to €251.7 billion at the end of 2021. However, taking into account new outstanding NGEU-related commitments of €89.9 billion, the total amount of outstanding commitments grew by €38.4 billion. Outstanding commitments are likely to exceed €460 billion in 2023; they will then fall as NGEU draws to a close (see paragraphs 2.26-2.32).
2.60. The total amount of commitments made to FISMs under the 2014-2020 MFF was €21.6 billion. By the end of 2020, €10.3 billion had been paid out from FISMs to final recipients, which is 47% of the total committed amount. There are significant differences between the Member States in how quickly they have absorbed funds under these instruments, as well as in the percentages of management costs (see paragraphs 2.33-2.36).

2.61. The NDICI superseded 11 former instruments under the previous MFF, as well as the actions previously financed by the EDFs, which had been outside the EU budget (see paragraph 2.37).

2.62. The Commission has still not produced a comprehensive report on COVID-19-related expenditure under the EU budget (see paragraphs 2.38-2.39).

2.63. The time available for implementing shared-management funds under the 2021-2027 MFF is shorter than under previous MFFs. NGEU financing and additional measures that may be introduced due to Russia’s war of aggression against Ukraine increase the amount of ongoing implementation activity. The challenges that we highlighted last year in relation to managing and controlling these funds to ensure compliance and sound financial management still exist (see paragraphs 2.40-2.41).

2.64. The EU budget’s total exposure to contingent liabilities increased from €131.9 billion in 2020 to €277.9 billion in 2021. The two main reasons for this substantial rise were the introduction of NGEU and the increase in the amount of loans provided under the SURE instrument (see paragraphs 2.42-2.44).

2.65. The risk to the EU budget from contingent liabilities is mitigated in several ways. The own resources ceiling has been increased, SURE loans are counter-guaranteed by the Member States, and the Common Provisioning Fund pulls together guarantee funds of the EU budget (see paragraphs 2.45-2.51).

2.66. Russia’s war of aggression against Ukraine will increase the EU’s budgetary needs. It will also lead to a higher risk of contingent liabilities to the EU budget being triggered (see paragraphs 2.52-2.54).
Recommendations

Recommendation 2.1 – Outstanding commitments

The Commission should inform the budgetary authority about the factors contributing to the evolution of outstanding commitments, and take appropriate action with a view to gradually reducing outstanding commitments in the long term.

**Target implementation date: By end 2023**

Recommendation 2.2 – Sustainability of the EU budget’s exposure

The Commission should closely monitor the increasing risk of contingent liabilities to the EU budget being triggered in connection with Russia’s war of aggression against Ukraine, and take action as necessary to ensure that risk mitigation tools maintain sufficient capacity.

**Target implementation date: By end 2022**
## Annexes

### Annex 2.1 – NGEU implementation by programme (in million euros)

<table>
<thead>
<tr>
<th>Programme</th>
<th>Total amount of commitment appropriations 2021-2023</th>
<th>Commitments made in 2021</th>
<th>Payments made in 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Horizon Europe</td>
<td>5 412</td>
<td>1 772</td>
<td>18</td>
</tr>
<tr>
<td>Invest EU Fund</td>
<td>6 074</td>
<td>1 745</td>
<td>151</td>
</tr>
<tr>
<td><strong>Heading 1. Single market, innovation and digital</strong></td>
<td><strong>11 486</strong></td>
<td><strong>3 517</strong></td>
<td><strong>169</strong></td>
</tr>
<tr>
<td>European Regional Development Fund (ERDF)</td>
<td>31 458</td>
<td>24 038</td>
<td>4 926</td>
</tr>
<tr>
<td>European Social Fund (ESF) and FEAD</td>
<td>19 161</td>
<td>15 435</td>
<td>2 081</td>
</tr>
<tr>
<td><strong>Heading 2.a. Economic, social and territorial cohesion</strong></td>
<td><strong>50 619</strong></td>
<td><strong>39 473</strong></td>
<td><strong>7 007</strong></td>
</tr>
<tr>
<td>Recovery and Resilience Facility (RRF) grants (incl. Technical Support Instrument)</td>
<td>337 969</td>
<td>98 034</td>
<td>46 375</td>
</tr>
<tr>
<td>Union Civil Protection Mechanism (RescEU)</td>
<td>2 056</td>
<td>129</td>
<td>2</td>
</tr>
<tr>
<td><strong>Heading 2.b. Resilience and values</strong></td>
<td><strong>340 025</strong></td>
<td><strong>98 163</strong></td>
<td><strong>46 376</strong></td>
</tr>
<tr>
<td><strong>Heading 2. Cohesion, resilience and values</strong></td>
<td><strong>390 644</strong></td>
<td><strong>137 463</strong></td>
<td><strong>53 384</strong></td>
</tr>
<tr>
<td>European Agricultural Fund for Rural Development (EAFRD)</td>
<td>8 071</td>
<td>2 366</td>
<td>65</td>
</tr>
<tr>
<td>Just Transition Fund</td>
<td>10 868</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td><strong>Heading 3. Natural resources and environment</strong></td>
<td><strong>18 939</strong></td>
<td><strong>2 371</strong></td>
<td><strong>65</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>421 070</strong></td>
<td><strong>143 525</strong></td>
<td><strong>53 618</strong></td>
</tr>
</tbody>
</table>
Chapter 3

Revenue
Contents

Introduction 3.1.-3.6.
Brief description 3.2.-3.3.
Audit scope and approach 3.4.-3.6.

Regularity of transactions 3.7.-3.8.

Examination of elements of internal control systems 3.9.-3.19.
Weaknesses persist in Member States’ accounting and management of TOR 3.10.-3.12.
The number of VAT reservations and TOR open points has decreased, but weaknesses in their management remain 3.15.-3.17.
The Commission’s work on GNI affected by delays from Member States 3.18.-3.19.

Annual activity reports 3.20.-3.23.

Conclusion and recommendations 3.24.-3.28.
Conclusion 3.24.-3.25.
Recommendations 3.26.-3.28.

Annexes
Annex 3.1 – The process of drawing up the TOR statements of duties (collected and not yet collected) and their entry in the EU accounts and budget
Annex 3.2 – Number of outstanding GNI reservations, VAT reservations and TOR open points by Member State at 31.12.2021
Annex 3.3 – Follow-up of previous recommendations
Introduction

3.1. This chapter presents our findings for revenue, which comprises own resources, external assigned revenue mostly financing the Recovery and Resilience Facility (RRF) expenditure\(^1\) and other revenue. Figure 3.1 gives a breakdown of revenue in 2021.

Figure 3.1 – Revenue – 2021 breakdown\((*)\)

\[\text{Total revenue 2021} \text{(*): } €239.6 \text{ billion}\]

\((*)\) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 11).

\((***)\) This amount represents the EU’s actual budget revenue. The amount of €178.9 billion in the statement of financial performance is calculated using accrual-based accounting.

Source: ECA, based on data from the 2021 consolidated accounts of the European Union.

---

\(^1\) This includes amounts borrowed by the Commission to provide non-repayable financial support to Member States in the context of NextGenerationEU (NGEU), which the EU will have to repay in the future.
**Brief description**

3.2. Two thirds of EU revenue (66 %) comes from the four categories of own resources:

(a) the *gross national income-based (GNI-based) own resource* provides 48.2 % of EU revenue, balancing the EU budget after revenue from all other sources has been calculated. Each Member State contributes in proportion to its GNI;

(b) *traditional own resources (TOR)* provide 7.9 % of EU revenue. They comprise customs duties on imports collected by the Member States. The EU budget receives 75 % of the total amount; Member States retain the remaining 25 % to cover collection costs;

(c) the *value added tax-based (VAT-based) own resource* provides 7.5 % of EU revenue. Contributions under this own resource are calculated using a uniform rate applied to the total amount of Member States’ VAT receipts collected in respect of all taxable supplies divided by the weighted average VAT rate;

(d) the *non-recycled plastic packaging waste-based own resource* provides 2.5 % of EU revenue. It was introduced in 2021 and is calculated by applying a uniform rate to the weight of unrecycled plastic packaging waste generated in each Member State.

3.3. External assigned revenue, which mostly relates to amounts borrowed to provide Member States with non-repayable financial support in the context of NGEU, provides 23.2 % of EU revenue. There are also other sources of EU revenue. The most significant of these are contributions and refunds connected with EU agreements and *programmes* (8.3 % of EU revenue), such as revenue relating to the *conformity clearance* of the EAGF and EAFRD, and non-EU countries’ contributions to EU programmes and activities.

---

Audit scope and approach

3.4. Applying the audit approach and methods set out in Annex 1.1, we obtained reasonable assurance for our audit opinion on revenue by assessing key selected systems, supplemented by transaction testing. Our objective was to contribute to the statement of assurance as described in Annex 1.1. We examined the following for revenue in 2021:\(^3\):

(a) a sample of 55 Commission recovery orders, designed to be representative of all sources of revenue;

(b) the Commission’s systems for:

   (i) ensuring that the Member States’ GNI, VAT and non-recycled plastic packaging waste data constitute an appropriate basis for the calculation and collection of own-resource contributions\(^4\);

   (ii) managing TOR and ensuring that Member States have effective systems for collecting and reporting the correct amounts of TOR and making them available;

   (iii) calculating the amounts resulting from correction mechanisms to own resources;

   (iv) managing fines and penalties;

(c) the systems for TOR accounting and management in three Member States (Ireland, Italy and Sweden) selected on the basis of both the amount of customs duties they collected and our risk assessment;

(d) the reliability of the information on regularity contained in DG BUDG and Eurostat’s annual activity reports.

---

\(^3\) The Commission’s systems for borrowing and lending operations related to NGEU were not part of our audit scope. The Commission’s debt management systems are scrutinised in our ongoing performance audit.

\(^4\) Our starting point was the agreed GNI data and the harmonised VAT base prepared by Member States. We did not directly test the statistics and data produced by the Commission and Member States. For the non-recycled plastic packaging waste base, we reviewed the process for compiling forecast data as Member States will not provide their 2021 statistical estimates until 2023.
3.5. Customs duties are at risk of either not being declared or being declared incorrectly to the national customs authorities by importers. The actual import duties collected will therefore fall short of the amount that should theoretically be collected. This difference is known as the “customs gap”. These evaded amounts are not captured in Member States’ TOR accounting systems and do not fall within the scope of our audit opinion on revenue. However, since the customs gap may affect the amounts of duties established by Member States, we assessed for a third year in a row the EU action taken to reduce the gap and mitigate the risk that TOR are not complete.

3.6. In doing so, we examined the progress achieved by the Commission in implementing the improvements set out in its Customs Action Plan, and in addressing the recommendations from our 2021 special report on customs controls\(^5\). We also looked at the Commission’s monitoring of the implementation of the Protocol on Ireland/Northern Ireland\(^6\) in relation to customs, and of its impact on the collection of TOR. Although the Protocol provides that duties collected on goods imported into the EU through Northern Ireland are not payable to the EU budget, it nevertheless requires the UK to ensure the proper application of the *Union Customs Code (UCC)*\(^7\) to these imports.

\(^5\) Special report 04/2021: “Customs controls: insufficient harmonisation hampers EU financial interests”.

\(^6\) The Protocol on Ireland/Northern Ireland is an integral part of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy.

\(^7\) Regulation (EU) No 952/2013 laying down the Union Customs Code.
Regularity of transactions

3.7. This section presents our observations on the regularity of revenue transactions. We have based our conclusion on the regularity of the revenue transactions underlying the EU accounts, and on our assessment of the Commission’s systems for calculating and collecting revenue. Our examination of a sample of 55 recovery orders revealed that none of them was affected by a quantifiable error.

3.8. We also noted that the Commission did not apply the methodology provided for in the Own Resources Decision to redistribute the cost of financing the United Kingdom (UK) correction following the adjustments for the years 2017 to 2019. Instead, it applied the standard method for redistributing ‘other revenue’ (as the UK’s contribution is categorised following its withdrawal from the EU), using the uniform allocation key based on Member States’ GNI as calculated for the 2021 annual budget. This resulted in a minor difference in the redistribution of costs among the Member States and hence on the calculation of their contributions to the EU budget. This did not affect our conclusion on the regularity of EU revenue.

---

8 See paragraph 11 in Annex 1.1.

Examination of elements of internal control systems

3.9. We selected and examined a number of systems (see paragraph 3.4). The observations on those systems do not affect our overall unmodified opinion on the regularity of EU revenue (see chapter 1). However, they highlight weaknesses in the collection of individual categories of own resources. In addition, we noted weaknesses in EU action to reduce the customs gap and mitigate the risk that TOR are incomplete.

Weaknesses persist in Member States’ accounting and management of TOR

3.10. In 2021, the Commission completed its examination of the systems national customs authorities use to compile TOR statements. It assessed the reliability of these statements as generally satisfactory in 11 Member States, partially satisfactory in 15 and not satisfactory in one (see Figure 3.2). Overall, this assessment is consistent with our audit results this year and in previous years. In our 2020 annual report, we found persistent weaknesses in the Netherlands’ compilation of TOR statements, and recommended that the country ensure the reliability of these statements by improving its customs IT system10.

Figure 3.2 – The Commission’s assessment of Member States’ reliability of TOR statements

![Figure 3.2](image)

Source: ECA, based on the Commission’s data.

---

10 2020 annual report, paragraph 3.14 and recommendation 3.3.
3.11. This year, we examined how three Member States (Ireland, Italy and Sweden) draw up their TOR statements (comprising a statement of duties collected and a statement of duties established but not yet collected)\(^\text{11}\), as well as their procedures for managing TOR owed to the EU budget (see Annex 3.1). We did not identify any significant problems in the way Ireland and Sweden drew up their statements. However, in Italy we found that weaknesses we had previously identified persist (see Box 3.1). These also affect the management of duties collected and not yet collected.

**Box 3.1**

**Persistent weaknesses in the national control system for compiling TOR statements**

Member States’ TOR statements need to be reliable and consistent in order to determine the amounts payable to the EU. The amounts recovered from outstanding customs debts have to be recorded in both the statement of duties collected and the statement of duties established but not yet collected.

Since 2011, Italy’s reporting on TOR has not been in line with the EU rules, as discrepancies persist between its two TOR statements concerning amounts recovered. These differences are mainly due to delays in updating the accounts of customs duties not yet collected with information on debt recoveries. The Italian authorities are developing an IT solution and have undertaken to resolve these problems by mid-2022.

These and other discrepancies detected in the audit trail left us unable to fully confirm the reliability of the Italian statements.

\(^{11}\) Commission Implementing Decision (EU, Euratom) 2018/194 establishing models for statements of accounts for entitlements to own resources and a form for reports on irrecoverable amounts corresponding to the entitlements to own resources pursuant to Council Regulation (EU, Euratom) No 609/2014.
3.12. We did not make any significant observations regarding the way Ireland or Sweden manage customs duties collected. However, as in previous years\(^\text{12}\), we did find several shortcomings in the way national customs authorities manage duties not yet collected. In particular, we noted weaknesses in the way Ireland and Italy manage the recovery of outstanding customs debts, and delays on the part of both countries in making recovered TOR available to the EU budget. Additionally, we found weaknesses in Italy’s management of late write-offs of irrecoverable duties in its accounts. The Commission also continues to detect and report weaknesses in this area. Our assessment of Member States’ key internal TOR control systems is presented in Figure 3.3.

**Figure 3.3 – Assessment of key internal TOR control systems in the Member States selected**

<table>
<thead>
<tr>
<th></th>
<th>Ireland</th>
<th>Sweden</th>
<th>Italy</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOR contributions in 2021</td>
<td>€0.4 billion (2 % of total TOR)</td>
<td>€0.5 billion (3 % of total TOR)</td>
<td>€1.7 billion (10 % of total TOR)</td>
</tr>
<tr>
<td>Compilation of the TOR statements</td>
<td>Generally effective</td>
<td>Generally effective</td>
<td>Not effective</td>
</tr>
<tr>
<td>Management of customs duties collected</td>
<td>Generally effective</td>
<td>Generally effective</td>
<td>Partially effective</td>
</tr>
<tr>
<td>Management of customs duties not collected</td>
<td>Not effective</td>
<td>Generally effective</td>
<td>Partially effective</td>
</tr>
</tbody>
</table>

*Source: ECA.*

\(^{12}\) See, for example, [2020 annual report](https://example.com), paragraph 3.16, [2019 annual report](https://example.com), paragraph 3.9, and [2018 annual report](https://example.com), paragraph 4.10.
Delays in Commission actions to improve TOR risk management and reduce the customs gap

3.13. The Commission’s Customs Action Plan\textsuperscript{13} includes actions on improving risk management, managing e-commerce, promoting compliance and encouraging customs authorities to act as one. Several actions are intended to address shortcomings previously highlighted in our reports\textsuperscript{14} and to contribute to reducing the customs gap. Our review of the Commission’s implementation of the plan revealed insufficient progress on a number of actions. We noted that five actions were permanent, 11 one-off actions with deadlines after 2021 were in progress, and 12 of the 13 one-off actions due for completion by the end of 2021 had been delayed (see Figure 3.4). For example, the Commission postponed the revision of the customs risk management strategy from June 2021 to September 2022.

\textsuperscript{13} Communication from the Commission “Taking the Customs Union to the Next Level: a Plan for Action” (COM(2020) 581), 28 September 2020.

\textsuperscript{14} See, for example, 2020 annual report, paragraph 3.18, special report 04/2021 and special report 12/2019: “E-commerce: many of the challenges of collecting VAT and customs duties remain to be resolved”.
**Figure 3.4 – The Commission’s implementation of its Customs Action Plan (as of end of 2021)**

<table>
<thead>
<tr>
<th>Area</th>
<th>Permanent actions (no fixed deadline)</th>
<th>deadline after 2021</th>
<th>deadline until 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL 29 actions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. More effective customs risk management to allow more effective controls</td>
<td>![2×2]</td>
<td>![2×2]</td>
<td>![1×1]</td>
</tr>
<tr>
<td>B. Managing e-Commerce</td>
<td>![0×1]</td>
<td>![3×1]</td>
<td>![1×1]</td>
</tr>
<tr>
<td>C. Strengthening and facilitating compliance</td>
<td>![3×1]</td>
<td>![2×1]</td>
<td>![9×1]</td>
</tr>
<tr>
<td>D. Customs working as one</td>
<td>![0×1]</td>
<td>![4×1]</td>
<td>![2×1]</td>
</tr>
</tbody>
</table>

*Source: ECA, based on Commission data and our own audit work.*

**3.14.** Any potential shortcomings in the implementation of the Protocol on Ireland/Northern Ireland may pose risks to the proper application of the UCC, particularly in respect of customs controls on the goods imported into the EU via Northern Ireland. This could have an impact on the amount of TOR collected by Member States. The Commission has begun developing its monitoring strategy to assess and mitigate these risks, but this work is not yet finished.
The number of VAT reservations and TOR open points has decreased, but weaknesses in their management remain

3.15. Figure 3.5 shows the process the Commission uses to verify Member States’ calculation of TOR and their VAT bases. Annex 3.2 provides an overview of the outstanding reservations and open points set for weaknesses detected. We found that the Commission had improved its follow-up work on the lifting of VAT reservations, the number of which decreased from 104 in 2020 to 82 in 2021 (i.e. by 21 %), and on closing TOR open points, the number of which decreased from 326 in 2020 to 304 in 2021 (i.e. by 7 %). Although we noted progress in resolving long-outstanding issues, we found eight VAT reservations (10 % of the total) and 104 TOR points (34 % of the total) that had been open for more than five years.

Figure 3.5 – The process of verifying Member States’ VAT bases and TOR

STEP 1: Calculating

**Member States**
- Establish and collect customs duties (75 % of which are TOR)
- Calculate VAT base (VAT-based own resources)

**Commission**
- Calculates the contributions to the EU budget

STEP 2: Verifying and setting

**Commission**
- Where shortcomings are detected, sets VAT reservation or TOR open point

**Commission**
- Inspects and verifies the accuracy of the information and data provided by Member States

STEP 3: Follow-up and lifting

**Member States**
- Address the shortcomings
- Inform the Commission
- Respond to follow-up requests

**Commission**
- Follow-up the progress made by Member States: assesses their actions, and requests additional information or actions.
- Lifts the reservation or closes TOR point, when considers them resolved

*Source: ECA, based on the Commission data.*
3.16. We reviewed the management of all 17 VAT reservations that concerned weaknesses in Member States’ application of the VAT Directive\textsuperscript{15} and for which the Commission had opened \textit{infringement procedures} or non-compliance investigations. Five of these were long-outstanding reservations. In 12 cases (71%), the infringement procedure or investigation process had already ended but the Member State concerned had not yet calculated its financial impact. In our view, this was due to the Commission’s not applying a common approach in setting deadlines for Member States to calculate and make the resulting financial corrections to their VAT-based own resources.

3.17. Our review of the management of TOR open points found that the number of open long-outstanding points had decreased significantly between 2019 and 2021, and that the Commission had updated its procedure for processing TOR inspection results. However, it did not include a system for ranking Member States’ shortcomings in order of priority. Nor did it set deadlines for their follow-up actions (see \textit{Annex 3.3}) based on Member States’ replies. The weaknesses we previously reported in relation to the closure of long-outstanding open points have therefore not yet been fully addressed.

\textbf{The Commission’s work on GNI affected by delays from Member States}

3.18. The Commission has started the new 2020-2024 GNI verification cycle. This examines whether the procedures Member States use to compile their national accounts comply with ESA 2010\textsuperscript{16}, and whether GNI data are reliable, exhaustive and comparable\textsuperscript{17}. We observed that 18 Member States and the UK had met the legal deadline of 31 December 2021\textsuperscript{18} for delivering their \textit{GNI inventories}, which describe their procedures for compiling statistical data, to the Commission. Four Member States submitted their inventories January 2022, and the Commission set GNI general

\begin{itemize}
  \item [16] Regulation (EU) No 549/2013 on the \textit{European system of national and regional accounts} in the European Union.
  \item [17] Regulation (EU) No 2019/516 on the harmonisation of gross national income at market prices.
  \item [18] Article 3 of Commission Implementing Regulation (EU) 2020/1546 establishing the structure and detailed arrangements of the inventory of the sources and methods used to produce gross national income aggregates and their components in accordance with the European System of Accounts (ESA 2010).
\end{itemize}
reservations\textsuperscript{19} for the remaining five in February 2022\textsuperscript{20}. These reservations may delay the closure of the GNI verification cycle.

\textbf{3.19.} We also found delays on the part of nine Member States (plus the UK)\textsuperscript{21} in addressing the GNI transaction-specific and/or transversal reservations\textsuperscript{22} set as part of the previous 2016-2019 verification cycle with a deadline of September 2021. These delays affect the Commission’s work on the lifting of the related reservations, which may not be completed in 2022 as planned. By the end of 2021, 24\% of GNI transaction specific reservations had been lifted (38 out of 157 open at the end of 2020, see \textit{Annex 3.2}). The Commission extended the deadline for addressing two of the five GNI transversal reservations\textsuperscript{23} by one year (until September 2022) due to delayed endorsement of the necessary guidelines for the Member States.

\textsuperscript{19} The Commission uses general reservations in exceptional cases where there is a significant risk of the EU’s financial interests not being protected; for example, when a Member State does not submit its GNI inventory as required.

\textsuperscript{20} Greece, Croatia, Luxembourg, Malta and Romania.

\textsuperscript{21} Bulgaria, Greece, Spain, Croatia, Luxembourg, Malta, the Netherlands, Poland, Romania and the UK.

\textsuperscript{22} \textit{GNI reservations} call for improvements in respect of specific compilation procedures in the Member States.

\textsuperscript{23} Unlike transaction-specific reservations, which are set for individual Member States, transversal reservations are used when an issue concerning the calculation of GNI affects all Member States and requires them to implement a harmonised solution, agreeing technical aspects with Eurostat.
Annual activity reports

3.20. The information on regularity provided in the 2021 annual activity reports published by DG BUDG and Eurostat generally corroborated our findings and conclusions.

3.21. For the sixth year in a row, DG BUDG has maintained the reservation that the TOR amounts transferred to the EU budget are inaccurate owing to undervaluation of textiles and shoes imported from China over the period from 2011 to 2017. The reservation was first set in 2016, when TOR losses attributable to the United Kingdom were quantified at €2.1 billion, and then extended to other Member States in 2018, without quantification. A further €2.1 billion of interest was also booked in the 2021 consolidated accounts of the European Union.

3.22. In our 2019 and 2020 annual reports, we noted that the Commission’s assessment of the Member States’ control strategies for tackling the risk of undervalued imports had found them to be inadequate overall.\(^{24}\) We examined the Commission’s follow-up of its findings in 2021, noting that for 22 Member States the related TOR open points were still outstanding. Our findings and conclusions are consistent with the information disclosed in the reservation set in DG BUDG’s annual activity report.

3.23. On 8 March 2022, the Court of Justice of the European Union (CJEU) published its final decision on the Commission’s infringement case against the UK. It concluded that the UK had failed to fulfil its obligations under EU law in respect of own resources. With its judgment, the CJEU approved the Commission’s method of quantifying of TOR losses based on statistical data. However, it partly rejected the Commission’s calculation due to uncertainty regarding the amount of own resources allegedly owed by the UK, and provided guidance on recalculating it. The Commission has started analysing the CJEU judgement and its impact on its calculations. It has not yet revised its estimate of TOR losses following the judgement.

Conclusion and recommendations

Conclusion

3.24. The overall audit evidence indicates that the level of error in revenue was not material. The revenue-related systems we examined were generally effective. However, the key internal TOR controls we assessed in certain Member States and the management of VAT reservations and TOR open points at the Commission were partially effective due to persistent weaknesses (see paragraphs 3.10-3.12 and 3.15-3.17).

3.25. We also found that the implementation of several actions in the Commission’s Customs Action Plan (see paragraph 3.13) that contribute to reducing the customs gap had been delayed. This weakness does not affect our audit opinion on revenue, as it does not concern the transactions underlying the accounts but rather the risk that TOR are incomplete.

Recommendations

3.26. Annex 3.3 shows the findings of our follow-up review of the two recommendations we made in our 2018 annual report. The Commission had implemented one recommendation in full, having improved its checks on TOR statements. The other recommendation had been implemented in most respects. This is because the Commission’s risk assessment does not systematically document the analysis of each Member State’s level of risk based on the results of previous TOR inspections, including in relation to the drawing-up of the TOR accounts.

3.27. We also reviewed two recommendations from our 2019 annual report that were targeted for implementation during 2021 (see Annex 3.3). The Commission had implemented one recommendation in some respects and the other one in most respects. In relation to recommendation 1a), the Commission has not yet collected and analysed import data at EU level to identify the riskiest importers (see paragraph 3.13). In relation to recommendation 1b), the delays in some Member States delivering the necessary data to feed into the upgraded ‘Surveillance III’ customs IT system may prevent the Commission from issuing timely guidance on how to use the system for data analysis. In relation to recommendation 2, see paragraph 3.17.
3.28. Based on this review and our findings and conclusions for 2021, we recommend that the Commission:

**Recommendation 3.1 – Take action to ensure reliability of the Italian TOR statements**

Take the necessary action (including infringement proceedings where appropriate) to ensure that Italy solves its long-outstanding weaknesses in TOR accounting. The action should aim to address the persistent discrepancies affecting the reliability of the country’s statements of duties collected and not yet collected.

**Target implementation date: by mid-2023**

**Recommendation 3.2 – Improve management of VAT reservations**

Review its procedures for managing VAT reservations, in order to set more harmonised and stricter deadlines for national authorities and make its follow-up and lifting of reservations more efficient.

**Target implementation date: by mid-2024**

**Recommendation 3.3 – Improve the assessment of financial risks in the area of customs**

Improve the assessment of financial risks for TOR by implementing the relevant measures of its Customs Action Plan in a timely manner.

**Target implementation date: by the deadlines set in the Customs Action Plan**
Annexes

Annex 3.1 – The process of drawing up the TOR statements of duties (collected and not yet collected) and their entry in the EU accounts and budget

**Economic operators**
- Present import declarations to national customs authorities
- Pay any duties required
- Import goods into the EU market

**Member States**
- Establish, book in the accounts and collect customs duties
- Report to the Commission

**In the scope of the Statement of Assurance**

**Monthly statement of duties collected**
- Member States
- Pay 75% of duties collected (TOR) into the EU budget

**Quarterly statement of duties not yet collected**
- Member States
- Take all necessary measures to ensure debt recovery
- Manage duties not yet collected

**EU accounts and budget**
- Entered in the accounts as revenue received
- Contributed to the annual EU budget

**EU accounts**
- Entered in the accounts as revenue to be received (receivables)

*Source: ECA, based on current EU legislation and rules.*
Annex 3.2 – Number of outstanding GNI reservations, VAT reservations and TOR open points by Member State at 31.12.2021

<table>
<thead>
<tr>
<th>Member State</th>
<th>TOR open points</th>
<th>VAT reservations</th>
<th>GNI reservations</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>42</td>
<td>17</td>
<td>3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>37</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Greece</td>
<td>18</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Belgium</td>
<td>29</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Poland</td>
<td>10</td>
<td>16</td>
<td>1</td>
</tr>
<tr>
<td>France</td>
<td>23</td>
<td>31</td>
<td>1</td>
</tr>
<tr>
<td>Romania</td>
<td>10</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>Germany</td>
<td>16</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>6</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>Croatia</td>
<td>5</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>Ireland</td>
<td>1</td>
<td>16</td>
<td>1</td>
</tr>
<tr>
<td>Portugal</td>
<td>17</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Malta</td>
<td>6</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>4</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Italy</td>
<td>9</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Spain</td>
<td>9</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Austria</td>
<td>4</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Sweden</td>
<td>5</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Finland</td>
<td>6</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Slovakia</td>
<td>3</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Lithuania</td>
<td>4</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>5</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Hungary</td>
<td>6</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Estonia</td>
<td>6</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Latvia</td>
<td>5</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Denmark</td>
<td>6</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Slovenia</td>
<td>5</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Cyprus</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

TOTAL 31.12.2021: 304 TOR open points, 82 VAT reservations, 121 GNI reservations

TOTAL 31.12.2020: 326 TOR open points, 104 VAT reservations, 157 GNI reservations

Source: ECA, based on the Commission’s data.25

---

25 The GNI reservation figures include only transaction-specific reservations regarding the data compiled as of 2010 in specific components of the national accounts of the Member States concerned. There are also five transversal reservations for each Member State and the United Kingdom, none of which was lifted in 2021.
## Annex 3.3 – Follow-up of previous recommendations

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2018</td>
<td>We recommend that the Commission:</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 1:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>by the end of 2020, implement a more structured and documented risk assessment for its TOR inspection planning, including an analysis of each Member State’s level of risk and of risks in relation to the drawing up of the A and B accounts.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 2:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>by the end of 2020, reinforce the scope of its monthly and quarterly checks of TOR A and B account statements by carrying out a deeper analysis of the unusual changes in order to ensure a prompt reaction to potential anomalies.</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>ECA recommendation</td>
<td>ECA’s analysis of the progress made</td>
</tr>
<tr>
<td>------</td>
<td>---------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2019</td>
<td>We recommend that the Commission: <strong>Recommendation 1:</strong> provide Member States with regular support in selecting the riskiest importers for post-release audits by: (a) collecting and analysing relevant import data at EU level, and sharing the results of its analysis with Member States (by the end of 2021); (b) once Surveillance III becomes operational, providing guidance on how to carry out data analysis within this new system (by June 2023).</td>
<td>X</td>
</tr>
<tr>
<td>Year</td>
<td>ECA recommendation</td>
<td>ECA’s analysis of the progress made</td>
</tr>
<tr>
<td>------</td>
<td>--------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Recommendation 2:**
by the end of 2021, revise its procedures by:

(a) establishing a system for monitoring TOR open points based on quantitative and qualitative criteria that rank shortcomings detected in Member States in order of priority, and

(b) setting deadlines for Member States to address such shortcomings, and for follow-up actions, including the calculation of late-payment interest and the recovery of amounts to be made available to the EU budget.

| | | | X | | | |

*Source: ECA.*
Chapter 4

Single Market, Innovation and Digital
## Contents

<table>
<thead>
<tr>
<th>Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Introduction</strong></td>
</tr>
<tr>
<td><strong>Brief description</strong></td>
</tr>
<tr>
<td><strong>Audit scope and approach</strong></td>
</tr>
<tr>
<td><strong>Regularity of transactions</strong></td>
</tr>
<tr>
<td><strong>Ineligible personnel costs still account for most quantifiable errors found in research expenditure</strong></td>
</tr>
<tr>
<td><strong>Incorrect calculation of the hourly rates</strong></td>
</tr>
<tr>
<td><strong>Quantifiable issues with time reporting</strong></td>
</tr>
<tr>
<td><strong>Ineligible adjustments to previous reporting periods and other errors in personnel costs</strong></td>
</tr>
<tr>
<td><strong>Private entities, in particular SMEs and new entrants, are prone to errors</strong></td>
</tr>
<tr>
<td><strong>Types of errors in other direct costs</strong></td>
</tr>
<tr>
<td><strong>Review of IT systems for research grants</strong></td>
</tr>
<tr>
<td><strong>Annual activity reports and other governance arrangements</strong></td>
</tr>
<tr>
<td><strong>Conclusion and recommendations</strong></td>
</tr>
<tr>
<td><strong>Conclusion</strong></td>
</tr>
<tr>
<td><strong>Annexes</strong></td>
</tr>
<tr>
<td><strong>Annex 4.1 – Follow-up of previous recommendations for 'Single Market Innovation and Digital'</strong></td>
</tr>
</tbody>
</table>
Introduction

4.1. This chapter presents our findings for Multiannual Financial Framework 1 ‘Single Market, Innovation and Digital’ (MFF1). Figure 4.1 gives an overview of the main activities and spending under this heading in 2021.

Figure 4.1 – Payments and audit population

![Graph showing payments breakdown by fund]

- **Research**: €10.8 billion (58.7%)
- **Space**: €2.6 billion (13.9%)
- **Transport, Energy and Digital**: €2.2 billion (11.8%)
- **InvestEU**: €1.5 billion (8.2%)
- **Others**: €1.4 billion (7.4%)

**2021 payments breakdown by fund**

- **Single Market, Innovation and Digital**: €18.5 billion (10.2% of EU budget spending)

**2021 audit population compared to payments**

- **2021 payments – total 18.5**
  - Pre-financing payments (*): €12.6
  - Single, interim, and final payments: €5.9

- **2021 audit population – total 14.3**
  - Clearing of pre-financing (*): €8.4
  - Single, interim, and final payments: €5.9

(*) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

Source: ECA, based on data from the 2021 consolidated accounts of the European Union.
Brief description

4.2. The programmes financed under ‘Single Market, Innovation and Digital’ are diverse and aim to finance EU investments that contribute to research and innovation, the development of trans-European transport networks, communications, energy, digital transformation and the single market, and space policy.

4.3. The principal programme for research and innovation remains Horizon 2020\(^1\) (H2020), while its successor Horizon Europe\(^2\) (HE) and predecessor Seventh Framework Programme FP7\(^3\) represent a very small proportion of our 2021 audit population. MFF also encompasses large infrastructure projects under the Connecting Europe Facility (CEF), Galileo space programmes (the EU’s global satellite navigation system), EGNOS (the European Geostationary Navigation Overlay Service) and the European Earth observation programme Copernicus. It includes the InvestEU fund, which, together with HE, also benefits from additional funding from the NextGenerationEU (NGEU).

4.4. Most spending on these programmes is managed directly by the Commission, including through executive agencies, and takes the form of grants to public or private beneficiaries participating in projects. The Commission provides pre-financing to beneficiaries upon signature of a grant agreement and reimburses the EU-funded costs they report, net of the pre-financing. The space programmes are generally managed indirectly on the basis of delegation agreements signed between the Commission and dedicated implementing bodies (such as the European Space Agency). The InvestEU financial instruments are implemented mainly by the EIB or EIF, which in turn use financial intermediaries.

---

2 The 2021-2027 Framework Programme for Research and Innovation.
Audit scope and approach

4.5. Applying the audit approach and methods set out in Annex 1.1, we examined the following for this MFF heading in 2021:

(a) a statistical representative sample of 130 transactions covering the full range of spending under this MFF heading. It consisted of 87 transactions in the area of research and innovation (84 for H2020 and 3 for FP7) and 43 under other programmes and activities, notably the CEF, other financial instruments, and space programmes. The beneficiaries audited were located in 21 Member States and six non-EU countries. Our objective was to estimate the level of error for this MFF heading and thereby contribute to our statement of assurance;

(b) selected IT systems to gain a deeper knowledge of the various information systems the Commission used for the research programmes (notably the eGrants suite), and review how management information flows have been established following the delegation of responsibilities from the Directorate-General for Research and Innovation (DG RTD) to the European Research Executive Agency (REA);

(c) the regularity information in the annual activity reports of the Directorate-General for Economic and Financial Affairs (DG ECFIN), DG RTD and REA, which is included in the Commission’s Annual Management and Performance Report (AMPR).
Regularity of transactions

4.6. Of the 130 transactions we examined, 55 (42 %) contained errors. Based on the 38 errors we have quantified, we estimate the level of error to be 4.4 % (see Figure 4.2). Figure 4.3 gives a breakdown of our estimated level of error for 2021, distinguishing between research and other transactions.

Figure 4.2 – Estimated impact of quantifiable errors

Estimated impact of quantifiable errors

<table>
<thead>
<tr>
<th>Year</th>
<th>Materiality</th>
<th>Estimated level of error</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>2.0 %</td>
<td>3.9 %</td>
</tr>
<tr>
<td>2021</td>
<td>1.9 %</td>
<td>4.4 %</td>
</tr>
</tbody>
</table>

7.0 % Upper error limit
1.8 % Lower error limit

Sample size

<table>
<thead>
<tr>
<th>Year</th>
<th>Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>133 transactions</td>
</tr>
<tr>
<td>2021</td>
<td>130 transactions</td>
</tr>
</tbody>
</table>

Source: ECA.

---

4 We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 1.8 % and 7.0 % (the lower and upper error limits respectively).
4.7. H2020 continued to represent the majority of the 87 research projects in our sample (over 97 %), whereas no HE project had yet been sampled for audit\(^5\). We have previously reported on the improvements in the programme design and the Commission’s control strategy in respect of H2020\(^6\). Certain simplifications, in particular establishing a flat rate for indirect costs, have made life easier for beneficiaries and have the potential to reduce the risk of error. However, the results of our audit work show that this has not reduced the error rate to below the 2 % materiality threshold.

4.8. H2020 and FP7 spending remains high risk and is a main source of errors that we detect. We found quantifiable errors relating to ineligible costs in 29 of the 87 research and innovation transactions in the sample. This represents 45 % of our estimated level of error for this heading in 2021.

---

\(^5\) 2021 was the first year of implementation of the HE framework programme. Its start was delayed by the regulation being adopted later than planned. By the end of the year only 19 grant agreements and 1 framework agreement had been signed, and a very limited number of payments executed (mainly pre-financing).

\(^6\) For example, in the 2018 annual report, paragraph 5.13 and in special report No 28/2018: “The majority of simplification measures brought into Horizon 2020 have made life easier for beneficiaries, but opportunities to improve still exist”.

---

**Figure 4.3 – Breakdown of the estimated level of error by error type**

<table>
<thead>
<tr>
<th>Error Type</th>
<th>Research</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ineligible direct personnel costs</td>
<td>34.5 %</td>
<td>3.0 %</td>
</tr>
<tr>
<td>Serious non-compliance with public procurement rule</td>
<td>31.3 %</td>
<td></td>
</tr>
<tr>
<td>Ineligible other direct costs (VAT, travel, equipment)</td>
<td>8.4 %</td>
<td>20.4 %</td>
</tr>
<tr>
<td>Absence of essential supporting documents/lack of audit trail</td>
<td></td>
<td>2.4 %</td>
</tr>
</tbody>
</table>

Source: ECA.
4.9. In the case of other programmes and activities, we detected quantifiable errors in 9 of the 43 transactions in the sample. These included:

(a) two cases of irregularity in the procurement procedure (one under CEF and the other at the European Union Agency for the Cooperation of Energy Regulators (ACER));

(b) works claimed and reimbursed twice (CEF project, see Box 4.3);

(c) reimbursement of costs not provided for in the framework contract (CEF);

(d) financing of an ineligible asset (CEF).

4.10. The Commission had applied corrective measures that directly affected five of the transactions we sampled. These measures were relevant to our calculations, as they reduced our estimated level of error for this chapter by 0.2 percentage points. In 12 cases of quantifiable error made by final beneficiaries, the control procedures put in place by the Commission failed to prevent, or to detect and correct, the error before the expenditure was accepted. Most of the undetected errors related to personnel costs (10 out of the 12 cases). Had the Commission, or the auditors contracted by beneficiaries\(^7\), made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 1.7 percentage points lower.

4.11. With regard to research expenditure, auditors contracted by the beneficiaries themselves at the end of a project provide certificates on financial statements (CFS). These certificates are intended to help the Commission check whether costs declared in the financial statements are eligible. However, we have repeatedly reported weaknesses in these certificates\(^8\). This year, we found that 9 of the 12 cases of detectable quantifiable errors had not been discovered by either the auditors providing the certificates, or the Commission.

---

\(^7\) One element of the Commission’s control system is the certificates on financial statements issued by auditors contracted by beneficiaries (see paragraph 4.11).

\(^8\) 2018 annual report, paragraph 5.15, 2019 annual report, paragraph 4.10, and 2020 annual report, paragraph 4.11.
Ineligible personnel costs still account for most quantifiable errors found in research expenditure

4.12. The rules for declaring personnel costs under H2020 remain complex, despite simplification efforts, and their calculation remains a major source of error in the cost claims. As we reported in our previous annual reports\(^9\) and special report No 28/2018, the methodology for calculating personnel costs has become more complex in some respects under H2020 (see paragraphs 4.14, 4.15), and this has increased the risk of error. Of the 29 transactions affected by quantifiable errors in our sample of research transactions, 26, i.e. more than 89 %, relate to ineligible personnel costs being declared and reimbursed.

Incorrect calculation of the hourly rates

4.13. The main cause of error in 18 cases out of 26 remains the incorrect application of the methodology for calculating personnel costs, particularly the hourly rates.

4.14. Beneficiaries cannot declare actual salary costs for the financial year underway unless they use the monthly hourly rate. However, our audits showed that the calculations involved in this option are too complex and therefore rarely correct. The main difficulty lies in allocating payments generated over a period of more than a month (such as holiday pay and the thirteenth month salary) to the months in which they were actually earned. The beneficiaries often make mistakes in this allocation, thereby calculating incorrect monthly rates.

4.15. As also reported in the previous annual reports\(^{10}\), the rule requiring the use of the annual hourly rate applicable in the most recent closed financial year to declare the costs relating to the subsequent (non-closed) reporting year also leads to errors. We found that this was evident again in 2021.

\(^9\) 2017 annual report, paragraph 5.34, 2018 annual report, paragraph 5.16, 2019 annual report, paragraph 4.11 and 2020 annual report, paragraph 4.13, as well as 2017 annual report, recommendation 1, which has still not been fully implemented.

4.16. Other issues which resulted in incorrect hourly rates being used include the use of inaccurate annual productive hours, and ineligible elements entered in the salary costs, such as ineligible bonuses.

Quantifiable issues with time reporting

4.17. In addition to the incorrect application of the methodology for calculating personnel costs, we have identified 11 quantifiable cases where weaknesses in the time recording resulted in ineligible personnel costs being declared. These mainly concerned hours claimed during absences, public holidays and weekends, as well as hours recorded by mistake, hours not recorded in the payroll (not paid) or not supported by time-sheets or other time records. The example in Box 4.1 illustrates such a case.

Box 4.1

Example of ineligible costs due to missing time records

Our review of the personnel costs declared by an SME revealed that there were no time records or other alternative evidence to support a large number of the hours charged to the project by two staff members. Moreover, based on the analysis of the time-sheets provided for the rest of the staff that we examined, we found that one staff member had declared 225 hours for the project, but no hours had been recorded in the time-sheets and in the case of two other staff members, hours had been claimed when they had been on annual leave. A total of 1 277 hours (50 %) out of the 2 550 hours that we examined, were ineligible.

Ineligible adjustments to previous reporting periods and other errors in personnel costs

4.18. A new rule introduced by H2020 was that adjustments to financial statements related to the hourly rate were to be exceptional, i.e. only to correct a mistake in the hourly rate calculation. Otherwise, costs that have already been declared cannot be adjusted/changed (e.g. to take account of a different hourly rate after the closure of the financial year). We found a few cases where the beneficiary had incorrectly made such adjustments to the personnel costs previously reported on the basis of hourly rates recalculated in the reporting period following the closing of the financial year.
4.19. Other errors in personnel costs included failure to respect the double-ceiling rule, the use of theoretical salary costs rather than actual figures, the declaration of ineligible months in the case of staff working exclusively on the project (months claimed in full when the staff had worked for less than half of the working days), and subcontracting declared as personnel costs. We also found ineligible costs related to an experienced researcher working on a Marie Skłodowska-Curie action (MSCA), as described in Box 4.2.

Box 4.2

Example of an ineligible experienced researcher benefitting from a Marie Skłodowska-Curie Individual Fellowships (IF) action

In the case of one MSCA (IF) project examined, the experienced researcher selected and employed by the grant beneficiary did not meet the eligibility conditions laid down for the action concerned. These conditions stated that, at the time of the relevant deadline for submission of proposals (10 September 2015), the experienced researcher either had to have held a doctoral degree, or had at least four years’ full-time equivalent research experience. The researcher had obtained the doctoral degree over two months after the above-mentioned deadline. Furthermore, based on the information submitted in the application for the grant and available to the Commission for its assessment and for our audit, the alternative condition had not been met either, since the researcher in question had started a full-time PhD study programme on 1 October 2011, so had only acquired four years’ research experience on 30 September 2015, which was also after the relevant deadline. The researcher, therefore, should not have been permitted to take part in the call and should not have been selected for the project, hence the related costs are considered ineligible.

Private entities, in particular SMEs and new entrants, are prone to errors

4.20. One of the strategies for boosting European research is to increase private-sector participation, especially by new entrants and SMEs. More than half of the quantifiable errors found (15 out of 29) involved funding for private beneficiaries, even though the transactions concerned accounted for just 44 (34 %) of the 130 transactions in the sample. SMEs made up 14 % of the sample but accounted for 33 % of the quantifiable errors.

4.21. Moreover, in nine out of the total quantifiable cases concerning SMEs, the single claims audited included multiple errors resulting in ineligible costs being
declared (one example is given in *Box 4.1*). These results indicate that SMEs are more error-prone than other beneficiaries, as is also confirmed by the Commission’s audits\(^{11}\) and in our previous annual reports\(^{12}\).

**Types of errors in other direct costs**

**4.22.** The types of errors we found in the other categories of costs included ineligible equipment costs due to the incorrect calculation of depreciation, costs not incurred, errors in the declaration of travel costs, incorrect exchange rates, and a works invoice claimed twice. *Box 4.3* details the latter error.

---

**Box 4.3**

**Works costs claimed and reimbursed twice**

We found in one CEF project that the beneficiary had declared in the cost claim for the period audited an invoice for works amounting to €7 681 757 that had been claimed and reimbursed in a previous reporting period. As a result, the related costs were incorrectly reimbursed twice.

---

\(^{11}\) 2019 annual report, paragraph 4.16.

\(^{12}\) 2018 annual report, paragraph 5.19, and 2019 annual report, paragraph 4.16.
Review of IT systems for research grants

4.23. The eGrants suite is the Commission’s corporate business solution for managing grants and experts, and integrates the systems used for the entire process, i.e. from work programme and call preparation through to grant workflow management (Compass) and on to management of the grant throughout its life cycle (Sygma). They are part of the different information systems used by the Commission to manage grants for the research programmes (see Figure 4.4).

Figure 4.4 – Integrated IT systems support the Commission and project participants at all stages of the grant process

MANAGE PROPOSALS | PROJECT LIFE CYCLE | REPORT

- SEP
- EMI
- ECS
- F&T Portal
- SYGMA
- COMPASS
- PDM
- CORDA
- ABAC
- ABAC

**SEPs:** System for submitting and evaluating proposals
**EMI:** System for managing external experts
**ECS:** System for external experts to submit their applications
**F&T Portal:** Single entry point for external users in the grants life cycle
**SYGMA:** Electronic grant management system
**COMPASS:** Integrated workflow system for grants, experts and audit management
**PDM:** Participant data management system
**CORDA:** Data warehouse of data from research and innovation programmes
**ABAC:** Information system for budgetary and accounting operations

Source: ECA.

4.24. In 2021, we reviewed the eGrants suite, focusing on Compass and Sygma, and the processes of ‘grant agreement preparation’ and ‘reporting and payment’ during grant implementation. We also assessed how eGrants and the Commission’s budget management system, ABAC, are linked. Through this work we aimed to gain
deeper knowledge of the IT environment used to manage and control the new HE programme.

4.25. Based on our limited review, we found that the systems are well integrated in the IT environment, with data and approvals being transferred automatically between the different systems. The Commission provides a tool in Sygma (the ‘Personnel Costs Wizard’) that supports participants’ reporting of personnel costs, and regularly promotes its use. However, less than 10% of participants use it. Its increased use – especially by SMEs and new participants – could potentially reduce the number of errors we detect in personnel costs.

4.26. In accordance with the current legal basis, there is no link between beneficiaries’ accounting systems and the Sygma reporting system. The Commission has the general financial data on projects required by its control framework. Any accounting information (invoice-level details), including supporting information, is made available for additional controls or audits on request. This means that it is not possible to carry out large-scale automatic controls.

4.27. With regard to the transfer of grant portfolios from DG RTD to REA in April 2021, we found that eGrants helped to facilitate these transfers. The process benefitted from the fact that all the Commission services involved have access to the same data in eGrants and that these data come from the same source.
Annual activity reports and other governance arrangements

4.28. The annual activity reports (AARs) we examined reflected the information available in the respective DGs/Executive Agencies and, based thereon, gave a fair assessment of the financial management in relation to the regularity of underlying transactions relating to MFF1 expenditure.

4.29. With regard to H2020, DG RTD reported an expected representative error rate of 2.29% for all DGs and other EU bodies managing EU research spending. The residual error rate, taking into account corrective actions, is 1.67% for DG RTD alone. The ex post audits underlying these error rates covered payments made over the 2014-2020 period. In order to resolve the methodological issue previously raised by the ECA, which had led to an understatement of the error rate, the Common Audit Service calculated a top-up based on 1,304 audits closed in 2020 and 2021, resulting in an increase in the error rate of 0.37 percentage points, which was disclosed in DG RTD’s AAR.

4.30. The residual error rate at the end of 2021 for DG RTD indicates that it meets the condition laid down by the Commission and, in consequence, no reservation was issued in respect of H2020 expenditure. The reported error rates decreased slightly in 2021.

4.31. As 2021 was the first year of implementation of HE, only a very limited number of payments had been executed (only pre-financing in DG RTD). Hence, DG RTD did not report a detected error rate for HE in 2021. The target the Commission has set for the HE residual error rate is no more than 2% by the end of the framework programme.

---

13 DG ECFIN, DG RTD and REA.

14 The error rate had been calculated as a share of all the accepted costs, instead of the amount actually audited. This meant that the denominator in the error calculation was higher, so the error rate was understated; 2018 annual report, paragraph 5.34.

15 The error rate target range for H2020 is 2% to 5%.

16 See footnote 5.
4.32. In its 2021 AAR, DG RTD disclosed 20 open Internal Audit Service (IAS) recommendations, two of which were overdue. Six of the open recommendations including one overdue, were classified as ‘very important’. The overdue ‘very important’ recommendation concerned reducing the financial exposure of the Research and Innovation budget by refocusing the control strategy. The IAS considers that the action plans for addressing the recommendation have only been partly implemented, and the measures for improving the quality of the contracted external auditors’ work have not yet been finalised.

4.33. In its AAR, REA reported a residual error rate of 1.75 % for H2020 and thus did not have to issue any reservation in respect of H2020 either.

4.34. With regard to REA, the IAS concluded that the internal control systems in place for the processes it had audited were effective, except in two areas, which were the subject of very important recommendations made following the audit of the Commission’s ‘single electronic data interchange area’ (SEDIA). The recommendations in question concerned inadequate personal data protection and delayed or insufficiently automated IT tools.

4.35. DG ECFIN’s main relevant expenditure under MFF1 in 2021 relates to (1) the provisioning of the European Fund for Strategic Investments (EFSI) and InvestEU and (2) European Investment Fund (EIF) capital and dividends. The estimated error rate reported for these components in 2021 was 0 %, reflecting the nature of the payments concerned, and the IAS concluded that the DG ECFIN internal control systems in place for the processes it had audited were effective.

4.36. We reviewed the information in the Commission’s 2021 AMPR regarding the estimated risk at payment in the policy areas under MFF1. The Commission calculated an error rate of 1.3 % for MFF1.
Conclusion and recommendations

Conclusion

4.37. The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Single Market, Innovation and Digital’ was material. Our testing of transactions under this MFF heading produced an estimated overall level of error of 4.4% (see Figure 4.2). Our results indicate that the level of error remains high for research and innovation expenditure, which was a main source of error, particularly in the area of personnel costs.

4.38. The estimated risk at payment presented in the AMPR is 1.3%. This percentage is below both materiality and our range of estimated level of error. Therefore, in our view, despite the measures already taken by the Commission, this rate remains understated.

Recommendations

4.39. Annex 4.1 shows the findings of our follow-up review of the recommendations we made in our 2019 and 2020 annual reports that were due to be implemented by 2021. The Commission has implemented three recommendations in full and one in most respects.

4.40. Based on this review and our findings and conclusions regarding 2021, we recommend that the Commission:

---

17 The recommendations we made in our 2018 annual report required action by the end of 2020. We therefore followed them up in the 2020 annual report.
**Recommendation 4.1**

Strongly encourages the use of the Personnel Costs Wizard (see paragraph 4.25) (made available in the participant portal), especially by certain categories of beneficiaries that are more prone to committing errors, such as SMEs and new entrants (for both H2020 and HE grants).

**Target implementation date: mid-2023 (H2020) and mid-2024 (HE)**

**Recommendation 4.2**

Issues guidance to beneficiaries on the specific differences, focusing on the eligibility aspects under HE, compared to H2020 and similar programmes.

**Target implementation date: mid-2023**

**Recommendation 4.3**

In the case of H2020, improves the existing *ex ante* controls in order to identify and eliminate potential ineligible adjustments made to the personnel costs submitted by the beneficiaries following recalculation of the hourly rates.

**Target implementation date: end 2022**

**Recommendation 4.4**

Further improves the guidance addressed to the independent auditors that beneficiaries contract to deliver the CFSs, in order to reduce the large number of weaknesses we identified in our audits of these certificates.

**Target implementation date: mid-2023**
Recommendation 4.5

For the next research programme, explores, in line with evolving business needs, the feasibility of extending the functionalities in eGrants for risk assessment and automatic checks, e.g. by exploiting other available data sources to make available, in digital format, additional key data supporting the confirmation of compliance.

Target implementation date: for the next MFF
# Annex 4.1 – Follow-up of previous recommendations for 'Single Market Innovation and Digital'

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2019</td>
<td><strong>We recommend that by mid-2021 the Commission:</strong>&lt;br&gt;<strong>Recommendation 1:</strong> Conduct more targeted checks on SMEs’ cost claims and enhance its information campaign regarding H2020 funding rules, with particular focus on these important beneficiaries.</td>
<td>x</td>
</tr>
</tbody>
</table>
We recommend that by 2021 the Commission:

**Recommendation 2:**
Carry out a campaign to remind all H2020 beneficiaries of the rules for the calculation and declaration of personnel costs, paying specific attention to the types of error described in paragraphs 4.11-4.15 of this chapter.

---

18 The Commission has launched communication campaigns intended to improve the calculation of personnel costs connected with H2020 grants, but weaknesses still persist (see paragraphs 4.12 to 4.19). The Commission has developed a Personnel Costs Wizard to guide the beneficiaries, but it is used by just 10% of the participants (see paragraph 4.25).
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td><strong>Recommendation 4:</strong> For H2020: — address the observations that arose following our review of the <em>ex post</em> audits with regard to documentation, sampling consistency and the quality of audit procedures, and — for the third round of contracted out audits, take appropriate measures to ensure that the auditors are fully aware of the H2020 rules, and verify the quality of their work.</td>
<td>X^{19}</td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 2:</strong> Implement actions, including a periodical review of the main causes of error in financial statements, providing guidance on complex issues such as subcontracting rules, and conducting information campaigns in order to reduce the error rate for H2020.</td>
<td>X</td>
</tr>
</tbody>
</table>

*Source:* ECA.

^{19} The ECA will verify the effectiveness of these measures in the coming years.
Chapter 5

Cohesion, resilience and values
Contents

Introduction 5.1.-5.13.

Brief description 5.2.-5.6.
Policy objectives and spending instruments 5.2.
Management of funds 5.3.-5.6.
Audit scope and approach 5.7.-5.13.

Regularity of transactions, AARs and other governance arrangements 5.14.-5.65.

Results of our testing of transactions and review/re-performance of audit work 5.15.-5.39.
Ineligible costs 5.18.-5.23.
Ineligible projects 5.24.-5.28.
Infringements of internal market rules 5.29.-5.37.
Absence of essential supporting documents 5.38.-5.39.

Our assessment of the work of audit authorities 5.40.-5.52.

The Commission’s assurance work and reporting of residual error rate in its annual activity reports 5.53.-5.65.

Conclusion and recommendations 5.66.-5.78.

Conclusion 5.66.-5.74.
Recommendations 5.75.-5.78.

Annexes

Annex 5.1 – Information on EU action in Member States and regions
Annex 5.2 – Follow-up of previous recommendations for ‘Cohesion, resilience and values’
5.1. This chapter presents our findings for MFF heading 2 ‘Cohesion, resilience and values’. Figure 5.1 gives an overview of the main activities and spending under this heading in 2021. For further details of the 2021 audit population, see paragraph 5.9.

Figure 5.1 – Payments and audit population

**Cohesion, resilience and values**
€80.1 billion (44.1 % of EU budget spending)

2021 payments breakdown by fund

- European Regional Development Fund (ERDF) and other regional operations: 45.5 (56.9 %)
- European Social Fund (ESF): 19.4 (24.2 %)
- Cohesion Fund: 9.7 (12.1 %)
- Erasmus+: 2.4 (3.0 %)
- CEF Transport: 1.0 (1.2 %)
- ESI: 0.6 (0.7 %)
- Others: 1.5 (1.9 %)
**2021 audit population compared to payments**

**Economic, social and territorial cohesion**

<table>
<thead>
<tr>
<th>2021 payments – total 75.7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-financing payments (*): 75.1</td>
</tr>
<tr>
<td>Single, interim, and final payments: 0.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2021 audit population – total 44.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual decision to accept the accounts: 40.8</td>
</tr>
<tr>
<td>Clearing of pre-financing (*): 2.6</td>
</tr>
<tr>
<td>Single, interim, and final payments: 0.6</td>
</tr>
</tbody>
</table>

**Resilience and values**

<table>
<thead>
<tr>
<th>2021 payments – total 4.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-financing payments: 3.6</td>
</tr>
<tr>
<td>Single, interim, and final payments: 0.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2021 audit population – total 3.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clearing of pre-financing: 3.1</td>
</tr>
<tr>
<td>Single, interim, and final payments: 0.8</td>
</tr>
</tbody>
</table>

(*): The payment figures for subheading 2a consist of annual advances and interim payments for the 2014-2020 *programming period* that were not included in the accounts underlying the assurance packages which the Commission accepted in 2021. In line with the harmonised definition of underlying transactions (for details see *Annex 1.1, paragraph 12 and 13*), these payments are considered pre-financing and thus were not part of our audit population for the 2021 annual report. They will be included in our audit population in the year the Commission accepts the corresponding accounts (e.g. in the 2022 statement of assurance for payments from the 2020/2021 accounting year).

*Source:* ECA, based on data 2021 from the *consolidated accounts* of the European Union.

**Brief description**

**Policy objectives and spending instruments**

**5.2.** Spending under this heading focuses on reducing development disparities between the different Member States and regions of the EU\(^1\) (subheading 2a), and actions to support and protect EU values, making the EU more resilient to present and

---

\(^1\) See Articles 162 and 174 to 178 of the *Treaty on the Functioning of the European Union* (p. 73 and pp. 81-82).
future challenges (subheading 2b). These objectives are implemented through the following funds and instruments:

(a) Subheading 2a (economic, social and territorial cohesion)

— the **European Regional Development Fund** (ERDF), which aims to redress the main regional imbalances through financial support for innovation and research, the digital agenda, small and medium-sized enterprises and the low carbon economy;

— the **European Social Fund Plus** (ESF+), which aims to achieve high employment levels, fair social protections and a skilled and resilient workforce, as well as inclusive and cohesive societies as a central factor in eradicating poverty; for the 2021-2027 programming period ESF+ includes the *Youth Employment Initiative (YEI)*, the *Fund for European Aid to the Most Deprived (FEAD)*, and the *EU Programme for Employment and Social Innovation*, all of which were previously separate;

— the **Cohesion Fund** (CF), which, in the interest of promoting sustainable development, finances environment and transport projects in Member States with a per capita GNI of less than 90 % of the EU average;

— a contribution from the Cohesion Fund to the **Connecting Europe Facility** (CEF), which finances projects belonging to the *trans-European networks*;

(b) Subheading 2b (resilience and values)

— **Erasmus+**, which supports education, training, youth and sport in Europe by promoting learning mobility and non-formal and active participation among young people;

— a number of smaller schemes, including **Creative Europe**, the *Citizens, Equality, Rights and Values Programme (CERV)*, and specific instruments created to promote economic recovery in the EU after the COVID-19 pandemic, such as **EU4Health** and the *Emergency Support Instrument (ESI)*.

**Management of funds**

**5.3.** The cohesion policy funds (the ERDF, the CF and the ESF) account for the bulk of expenditure under this heading. They are implemented through *shared*

---

2 We report on 2021 *Recovery and Resilience Facility (RFF)* expenditure in *chapter 10*.

3 Regulation (EU) 2021/1153 establishing the Connecting Europe Facility.
management. Member States submit multiannual operational programmes (OPs) for the entire duration of an MFF. After the Commission has given approval, responsibility for implementing an OP is shared between the Commission (DG Employment, Social Affairs and Inclusion (DG EMPL) and DG Regional and Urban Policy (DG REGIO)) and the Member State. Beneficiaries receive reimbursement through authorities in the Member State, and the EU co-finances the eligible costs of operations approved in line with the terms of the OP. Managing authorities carry out verifications to prevent ineligible expenditure from being certified to the Commission. Their management role is key to ensuring the regularity of cohesion spending.

5.4. The control and assurance framework in place for spending under shared management aims to ensure that the residual error rate in an OP’s annual accounts remains below the 2% materiality threshold set in the applicable regulation. To ensure that no material level of irregularities remains in the accounts to be certified to the Commission after managing authorities’ verifications, the control and assurance framework includes the following three elements:

— The work performed by audit authorities on expenditure included in the annual accounts. This work results in an annual control report which Member States submit to the Commission as part of their assurance packages. The report contains the residual error rate for the OP (or group of OPs) and an audit opinion on the regularity of declared expenditure and the effective functioning of management and control systems.

4 We gave full details of the control and assurance framework for the ‘European structural and investment funds’ under the 2014-2020 programming period, including a timeline, in our 2017 (paragraphs 6.5-6.15) and 2018 annual reports (Figure 6.1).

5 In its AARs the Commission refers to a ‘residual risk rate’ (RRR) when dealing with closure for the 2007-2013 programming period and to a ‘residual total error rate’ (RTER) when dealing with the 2014-2020 programming period. In this chapter, we refer to both as ‘residual error rate(s)’.

The Commission’s annual acceptance of the accounts. For this purpose, the Commission carries out mainly administrative checks focusing on completeness and accuracy so that it can accept the accounts and release the amount of 10% retained earlier as a guarantee.

Commission desk reviews of each assurance package, and selected compliance audits in Member States. The Commission makes these checks to conclude on and validate the residual error rates reported by audit authorities; it publishes these, together with a weighted average to serve as a key performance indicator, in its annual activity reports (AARs) for the following year.

5.5. The process leading up to the closure of OPs from the 2007-2013 programming period was largely comparable to that described in paragraph 5.4.

5.6. EU funding through programmes not under shared management is disbursed in the form of grants, procurement and prizes, and is managed either directly by Commission DGs, or indirectly with the support of partner organisations or other authorities.

Audit scope and approach

5.7. Our objective was to contribute to the overall statement of assurance as described in Annex 1.1, and to provide an assessment of the regularity of expenditure both under MFF heading 2 as a whole and for the cohesion policy funds (subheading 2a). As regards the latter, we also aimed to assess the extent to which the audit authorities’ and the Commission’s work can be relied upon.

5.8. Applying the audit approach and methods set out in Annex 1.1, for this MFF heading in 2021 we examined:

— A statistically representative sample of 243 transactions covering the full range of spending under this MFF heading. Our objective was to estimate the level of error for the heading and to contribute to the statement of assurance. For the cohesion policy funds, the sample consisted of 217 transactions for which expenditure had

---

7 See Article 130 of the Regulation (EU) No 1303/2013, which limits the reimbursement of interim payments to 90 %.

8 DG EMPL, DG CNECT, DG EAC, DG SANTE, DG JUST, DG ECHO and European Climate, Infrastructure and Environment Executive Agency (CINEA) under the supervision of DG MOVE in relation with expenditure in our 2021 population.
been certified in assurance and closure packages (including 213 which had been checked previously by an audit authority), as well as eight financial instruments (subheading 2a). The sample also included 18 transactions directly or indirectly managed by the Commission (four under subheading 2a and 14 under subheading 2b).

— The work done by audit authorities to validate the information contained in the 33 assurance/closure packages concerned by the 213 transactions they had previously checked.

— The Commission’s work to review and validate the residual error rates reported in assurance packages for 2014-2020, and its audit work on regularity aspects of those packages.

— The regularity information given in the annual activity reports of DG EMPL and DG REGIO and then included in the Commission’s Annual Management and Performance Report (AMPR).

5.9. Our audit population (€47.9 billion) consisted mainly of expenditure from the 2014-2020 period that was included in accepted accounts submitted in assurance packages for the 2019/2020 accounting year (402 OPs worth a total of €40 billion). It also included 2007-2013 expenditure under the 18 OPs which the Commission closed or partially closed in 2021 (€776 million). The Commission had not yet approved any OPs for the 2021-2027 period and did not make any payments for this period by the end of 2021.

5.10. We took our sample of 217 transactions with expenditure certified in assurance and closure packages in two stages. We first selected 33 packages (31 from 2014-2020 and two from 2007-2013) covering 44 OPs. From those we then sampled transactions which the audit authorities had previously checked.

---

9 If issues having a material impact remain open, the Commission settles only the uncontested amount. The balance is settled and the OP closed once all outstanding issues have been resolved.

10 See paragraphs 2.6-2.8.
5.11. The Member States reported disbursements through financial instruments in the 2019/2020 accounting year under 108 OPs (€2.1 billion). We therefore took an additional sample covering eight financial instruments from the 2014-2020 period from which payments had been made to or for the benefit of final recipients. We thus examined 50 loans and 21 equity investments.

5.12. In addition, in 2021 the Commission paid or cleared €5 billion for programmes under its direct or indirect management, including €3.9 billion in expenditure under subheading 2b. We examined a sample of 18 transactions financed from the ESI, the CF contribution to the CEF, CERV, Creative Europe or Erasmus+.

5.13. **Annex 5.1** contains a breakdown of our sample of transactions and the quantifiable errors we found in the 27 Member States and the United Kingdom for subheading 2a for the 2014-2020 period.
Regularity of transactions, AARs and other governance arrangements

5.14. This part of the chapter consists of three sections. The first reports our testing of this year’s sample of 243 transactions with a view to providing insight on the main sources of error. The second section provides our assessment of audit authorities’ work, and the third relates to the Commission’s work. Our conclusion on the regularity information on cohesion spending contained in the two responsible DGs’ AARs and the AMPR is based on our findings from these three sections.

Results of our testing of transactions and review/re-performance of audit work

5.15. In the 243 transactions we examined, we identified and have quantified 30 errors, all relating to subheading 2a. Taking account of the 56 quantifiable errors previously found by audit authorities and corrections applied by programme authorities (worth a total of €458 million for both programming periods combined), we estimate the level of error for MFF heading 2 to be 3.6 %11 (see Figure 5.2).

11 The estimated level of error for subheading 2a only is 4.1 % (lower error limit 2.1 %, upper error limit 6.1 %).
The quantifiable errors reported by audit authorities concerned ineligible costs (32 cases), public procurement (19), missing supporting documents (eight), and accounting and calculation errors (two)\textsuperscript{12}. The Member States had applied financial corrections, extrapolating them as necessary, with a view to bringing the residual error rates to or below the materiality threshold of 2 %. 

\textbf{5.17.} Figure 5.3 shows how the errors we found break down by category (before taking account of financial corrections). Ineligible costs and projects, infringements of internal market rules and the absence of essential supporting documents contributed most to our estimated level of error. Paragraphs 5.18-5.39 provide more information on these errors.

\textsuperscript{12} A single transaction may be affected by more than one type of error.
Ineligible costs

5.18. When Member State authorities declare expenditure to the Commission in their accounts, they certify that it was incurred in compliance with the applicable EU and national rules, and that aid was granted to beneficiaries and operations that met the OP eligibility requirements.

5.19. Ineligible costs are the most frequent error found by audit authorities. According to their reporting, using a common typology agreed with the Commission\(^\text{13}\), 57% of all the errors they identified during the 2019/2020 accounting year were of this type.

5.20. In our sample we found additional cases of ineligible costs in 19 transactions. These cases accounted for 63% of the number of quantifiable errors we found, and approximately 1.6 percentage points of the estimated level of error (41% error contribution, see Figure 5.3). In some cases, the audit authority had detected an error but failed to quantify it correctly.

---

\(^{13}\) See Boxes 6.5 and 5.7 of the 2018 and 2019 annual reports respectively.
5.21. The main causes of ineligibility were ineligible participants, non-compliance with EU or national rules, and expenditure not actually related to the project. *Box 5.1* gives an example of ineligible expenditure.

**Box 5.1**

**Costs declared for activities outside the eligibility area**

In the Netherlands, for an ERDF operational programme, we found that the managing authority had declared costs for activities that were carried out by three out of 12 partners located outside the geographical area of eligibility. In such cases, the CPR requires the monitoring committee to give prior approval. This was not done. In particular, we found that, while the monitoring committee had discussed whether to fund these projects in 2016, it did not include them in the list of selected projects. It was not until February 2022, after our audit, that the committee took a formal decision to include them in the programme. Against this background, we consider the expenditure declared by these partners to be ineligible.

5.22. In four transactions we found that beneficiaries and programme authorities checked compliance with basic eligibility requirements on the basis of self-declarations by participants rather than independent sources (see *Box 5.2*). 

**Box 5.2**

**No verification of participant status**

In France, the *NEET* status of the participants in two YEI projects was checked solely against self-declarations.

In one of the ESF programmes concerned, the beneficiary could not provide any independent evidence that participants were not in employment, training or education. We requested additional checks from the Commission and national authorities to establish the participants’ status. This showed that nine out of the 37 participants were actually in employment, making them ineligible for EU support.

We found similar cases in another French project and an Irish ESF OP.

5.23. Beneficiaries made use of *simplified cost options (SCOs)* for 65 transactions, or 27 % of our sample, applying either flat rates, standard scales of unit costs or a combination of both. SCOs have the potential to reduce both beneficiaries’
administrative workload and errors. This year, we found errors relating to the use of SCOs in four transactions in one Member State, which, however, we have not quantified (see Box 5.3).

Box 5.3

Methods used for reimbursing beneficiaries and declaring expenditure to the EU budget for SCOs not in line with regulatory requirements

When SCOs are used, reimbursements made by the Member State to the beneficiary and by the Commission to the Member State should be based on the same method (Article 131(2) CPR).

In Ireland, an intermediate body signed funding letters with beneficiaries which provided for actual costs to be the basis for reimbursement. Subsequently, however, the managing authority used SCOs to calculate the amount of EU funding to be provided for this ESF programme. In this context, the four beneficiaries in our sample were required to submit expenditure claims listing only the direct staff costs incurred for the project, complemented by a flat-rate amount to cover other eligible expenditure.

But in reality, the Irish authorities reimbursed beneficiaries at actual cost, according to the requirements of the funding letters.

As a result, the amount reimbursed by the Member State to beneficiaries and the amounts reimbursed by the Commission to the Member State were based on different forms of support. This approach is also not in line with the regulatory requirements for SCOs.

Moreover, the double-reporting requirement goes against the legislators’ intention of using SCOs to reduce the administrative burden on beneficiaries.

Ineligible projects

5.24. We identified five projects that were granted aid although they did not meet the eligibility conditions listed in the applicable regulation and the corresponding OPs. Three of them were selected during the 2014-2020 period, and two during 2007-2013. These projects accounted for 17 % of all the quantifiable errors we detected, or approximately 1.4 percentage points of the estimated level of error.

5.25. Box 5.4 gives an example of an ineligible ERDF project.
Box 5.4

Projects previously supported through national funds were reassigned to receive EU support outside the eligibility period

The cut-off date for the eligibility of expenditure under 2007-2013 operational programmes was the end of 2015. In 2016, several projects were retroactively selected for EU co-financing under a regional ERDF programme in Italy. The regional authorities considered these projects eligible because they had been implemented in 2015 and earlier, but under a national programme and using national funds. We also found that the beneficiary never applied for EU funding.

Including an operation in an OP after the eligibility period, and after the expenditure has been incurred, goes against the principle that the eligibility rules must be applied in a fair, equitable and uniform manner. In particular, all operations must be selected and implemented in accordance with the regulation.

Projects that were not carried out as part of a programme cannot be qualified as operations within the meaning of the 2007-2013 CPR, and are therefore ineligible.

5.26. We also found that three projects in our sample for the ESF/YEI were ineligible for EU funding because they did not specifically provide support to young persons not in employment, education or training (see Box 5.5).
Box 5.5

Retroactive registration of NEETs in the Youth Guarantee

We audited several operations financed under the YEI in Spain. Four of these operations concerned rebates of employers’ social security contributions linked to interim contracts signed with NEETs (people not in employment, education or training).

National YEI legislation and the OP covering these operations require NEET participants to be registered with the national Youth Guarantee system. This registration gives NEETs access to a number of assisting measures (such as personalised guidance and individual action planning, including tailor-made individual support schemes), but also serves to verify their compliance with the NEET requirements.

Three of the four audited operations, concerning social security rebates, were registered retroactively in the national system, in some cases even years after the rebate was applied. The national entity responsible for managing social security rebates, which is both the intermediate body and the beneficiary of the operations did this without any previous knowledge of the NEET participants.

This retroactive registration made it impossible to validate the eligibility of participants as not being in education or training. Because there were no such verifications, the Commission had already applied a 25% financial correction before we performed our audit.

We consider that the retroactive registration of participants renders the three audited operations ineligible for EU funding. This is because, as well as making it impossible to verify whether participants are in education or training, it makes their registration in the national system non-compliant with other conditions of the Youth Guarantee and YEI. Most importantly, it means that NEETs are deprived of all the additional benefits available under those two schemes.

5.27. Another project we examined in Spain (one not affected by retroactive registrations) was also part of an action granting social security rebates and support for the hiring of young people for a certain minimum duration. The Commission has clarified to the Spanish authorities that indefinite recruitment should be encouraged. To this end, it has informed them that, if it is necessary to use temporary contracts, these should be for a minimum duration of six months, and that this condition should be checked before expenditure is certified. Despite this, the Spanish authorities accepted contracts with a minimum duration of 28 days, far shorter than the period indicated by the Commission. We therefore consider that rebates claimed under the YEI in relation to these temporary contracts ineligible. We also detected other issues
affecting the eligibility of expenditure. For example, EU-funded social security rebates for NEETs temporarily replacing other workers were also extended to the people they replaced – even though, by definition, those in the latter group were already in employment. The errors presented in this paragraph also apply to the three other operations we found to be ineligible (see Box 5.5).

5.28. We found similar problems with other ESF operations in previous years in the same Member State. We have already reported several times, in relation to both the 2007-2013 and 2014-2020 programming periods, on co-financed projects that did not meet the eligibility requirements in the corresponding OP and/or the relevant regulation, but that were not detected either by the Member State authorities or by the Commission.

Infringements of internal market rules

5.29. This year we found 19 infringements of internal market rules, four of which were quantifiable. Five of the infringements related to state aid, and 14 to public procurement.

Five projects infringed state aid rules

5.30. Unless below a ‘de minimis’ ceiling, state aid is incompatible with the internal market since it may distort trade between Member States. However, there are exceptions to this rule, in particular if a project is covered by the General Block Exemption Regulation (GBER) or if the Commission specifically gives its approval.

5.31. This year we identified five ERDF projects that infringed the EU’s state aid rules. We consider that three of them should have obtained less public funding, or none at all, from the EU and/or the Member State. These accounted for 0.7 percentage points of the estimated level of error. We have not quantified the other two errors, as they had no impact on the level of public funding. We provide an example of a state aid error in Box 5.6.

14 E.g. Example 8 in Annex 6.3 in the 2016 annual report.

15 Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market (GBER).
Box 5.6

Aid granted to excluded sector

A financial instrument in Hungary provided a loan and a grant in support of a company’s research, development and innovation activities. The loan related to the development of an optimised self-cleaning drying system, and the beneficiary was active in the primary agricultural sector. The managing authority approved the construction of a drying facility under the GBER regional investment aid scheme. Since that scheme excludes payments for agricultural activities, the construction element of the project was ineligible.

We found other state aid errors in Portugal and Poland.

Member States had detected many procurement errors in cohesion spending

5.32. Public procurement is a key instrument for spending public money economically and efficiently and establishing the internal market. Procurement is also a major source of the irregularities reported by audit authorities. They had detected 19 cases of non-compliance with public procurement rules in the transactions we examined, and had imposed flat-rate corrections ranging from 5 % to 100 %, as provided for in a Commission decision\(^{16}\). In terms of frequency, public procurement infringements account for 14 % of all errors audit authorities reported in the 2019/2020 accounting period, but they represent fully 36 % of the value of reported irregularities.

5.33. This year, we examined 133 procedures to procure works, services or supplies. The vast majority were for projects co-financed through ERDF/CF OPs. Eight of the 133 procedures related to projects under subheading 2b, which are also bound by the procurement rules.

\(^{16}\) Commission Decision C(2013) 9527, replaced by Commission Decision C(2019) 3452 (and its Annex) laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on public procurement.
5.34. In eight procedures for cohesion, we identified cases of non-compliance with EU and/or national public procurement rules that were not detected by the audit authorities. One case was a serious infringement that affected the procurement outcome, and we are reporting this as a quantifiable error. It accounted for 3% of all the quantifiable errors we found, or approximately 0.1 percentage points of the estimated level of error. The errors we have not quantified related to the use of criteria that may have prevented certain companies from bidding.

Specific procurement weaknesses affecting direct management transactions

5.35. In April 2020, the Commission activated the Emergency Support Instrument (ESI)\(^\text{17}\) and issued a communication explaining the options available in public procurement for dealing with issues relating to the COVID-19 crisis\(^\text{18}\). According to the communication, the EU procurement rules provided the necessary tools to meet the challenge, during the health crisis, of acquiring supplies, services and, where needed, additional infrastructure. The communication also explained the rules on using negotiated procedures without prior publication, including for example, that they should only be used to meet immediate needs.

5.36. Seven of the 18 transactions in our sample for sub-heading 2b concerned payments made under the ESI in 2021. In six of these cases we found weaknesses in the procurement of services or supplies. In one case, the Member State authority did not follow EU procurement rules because it assessed, incorrectly, that these did not apply to the expenditure it was claiming from the Commission. In another case, the Commission made use of a previous agreement which was not entirely suited to the purchased services. The four remaining cases correspond to weaknesses in the Commission’s implementation and verification of contract terms (see Box 5.7).

\(^{17}\) Regulation (EU) 2020/521 activating the emergency support taking into account the COVID-19 outbreak.

\(^{18}\) Communication from the Commission 2020/C 108/I/01 of 1 April 2020 – Guidance from the European Commission on using the public procurement framework on the emergency situation related to the COVID-19 crisis.
The Commission concluded advance purchase agreements (APAs) for COVID-19 vaccine doses with eight manufacturers. Our audit covered the clearing of advance payments made by the Commission in relation to four APAs under the ESI. Under the overarching agreement reached between the Commission and the Member States, the purchase price of any vaccine, as well as the cost of advance funding, was required to be based on a transparent estimate of production costs and resources already granted from other public sources. In addition, up-front payments under the APAs must be used by manufacturers to de-risk the necessary investments in vaccine development, clinical trials and preparation of the necessary at-scale production capacity along the entire value chain for rapid deployment in the EU of millions of vaccine doses.

We found that the procedures did not guarantee a transparent estimate of production costs. Moreover, there were no specific checks in place to ascertain whether advance payments were used as intended. One manufacturer claimed not to need any upfront financing to de-risk the necessary investments, but the Commission agreed nevertheless to an upfront payment. Lastly, two of the APAs we audited included an obligation to supply vaccine doses at no profit. We were unable to obtain any evidence from the Commission that the prices paid to the two manufacturers concerned did not include a profit margin.

5.37. We have not quantified these errors since, in every case we examined, the extraordinary nature of the pandemic supported direct contracting. In 2022, we published a special report on COVID-19 vaccine procurement19.

Absence of essential supporting documents

5.38. Beneficiaries and programme authorities are required to maintain systems and procedures that ensure an adequate audit trail. This includes the keeping of documentary records. The absence of supporting documents and information made up 15 % of all the errors reported by audit authorities for the 2019/2020 accounting year. The proportion was 13 % in the case of the ESF and 19 % in that of the ERDF/CF, though respectively these funds accounted for 30 % and 2 % of the total value of errors.

---

19 Special report 19/2022: “EU COVID-19 vaccine procurement: sufficient doses secured after initial challenges, but performance of the process not sufficiently assessed”.
5.39. We found that supporting information or documentation was missing in four of the transactions we examined. We have quantified two of these errors because the programme authorities or beneficiaries could not provide essential documents demonstrating compliance with the eligibility conditions. The result accounted for approximately 7% of the transactions we have quantified, and 0.1 percentage points of the estimated level of error.

**Our assessment of the work of audit authorities**

5.40. Audit authorities are the ‘second line of defence’ in the framework for assurance and control of spending. They verify, on a sample basis, the regularity of expenditure declared by managing authorities to the Commission. This year, we assessed the work of 23 out of 116 audit authorities, in 19 Member States and the UK. Our sample comprised 31 assurance and two closure packages. In all cases, the audit authorities had initially reported a residual error rate equal to or below 2%.

5.41. In its AARs, taking account of its own audit work and the preliminary results of our audits, the Commission adjusted the residual error rate for nine of the 31 assurance packages in our sample to above 2% (39% of the expenditure sampled). This includes two cases where the Commission had excluded advances to financial instruments previously included by audit authorities. We found no additional errors in those two cases (5% of the expenditure sampled).

5.42. Our work on this year’s sample shows, however, that the residual error rate was above 2% in 12 of the 31 assurance packages (corresponding to 39% of the expenditure sampled), also taking account of the additional errors detected following the Commission’s verifications.
5.43. Since 2017, we have examined an annual sample of assurance packages. During that time we have covered 69 assurance packages in 24 Member States\textsuperscript{20} and the UK at least once, corresponding each year to between 34 % and 62 % of the expenditure certified in annual accounts. Taking account of the Commission’s adjustments and our own audit findings, 37 of these packages (54 %) have had residual rates above 2 % in at least one year. The 37 packages have consistently accounted for at least 39 % of the expenditure in our sample (see Figure 5.4). This illustrates the extent to which audit authorities incorrectly report that residual error rates are below the 2 % materiality threshold.

Figure 5.4 – Assurance packages with a residual rate above 2 % (2017 to 2021)

Source: ECA.

5.44. Our audit results over the last five years demonstrate that the controls currently in place do not yet sufficiently offset the high inherent risk of error in this area. This is particularly true of managing authorities, whose verifications are still partly ineffective for preventing or detecting irregularities in the expenditure declared by beneficiaries. Although audit authorities play a key role in the assurance framework for cohesion, effective management control is indispensable to ensure both the performance of operations and their compliance with the legal framework.

\textsuperscript{20} All Member States except Denmark, Luxembourg and Malta.
5.45. The main contribution to the estimated level of error comes from weak decision-making by managing authorities, for example when approving ineligible projects or unlawful state aid. We have also observed that audit authorities report relatively low levels of this type of error. *Figure 5.5* provides an overview of this issue.

**Figure 5.5 – Share of ineligible projects and state aid errors**

![Diagram showing the share of ineligible projects and state aid errors from 2018 to 2021.]

Source: ECA.

5.46. One important factor in the effectiveness of the assurance and control framework is good collaboration and feedback between managing and audit authorities. We have identified a good practice that exemplifies how cooperation between managing and audit authorities can improve the quality of checks and, as a result, reduce the number of errors (see *Box 5.8*).
**Box 5.8**

**Cooperation between managing and audit authorities**

The Bulgarian audit authority cooperates with the managing authorities by publishing on its website:

- its checklists for systems audits and audits of operations (including public procurement procedures and state aid) to be used as appropriate by the managing authorities;
- an annual analysis of the errors revealed by its audit work; and
- a summary of public procurement irregularities, with guidance on how to avoid them.

We identified no irregularities in any transactions reviewed by this audit authority and included in our 2021 sample.

**Some audit authorities need to improve the audit trail for their sampling**

**5.47.** Owing to the large number of operations co-financed by each OP, audit authorities have to use sampling to form an opinion on the eligibility of expenditure. To produce reliable result, samples must be representative of the audited population and, as a general rule, based on a statistically valid method. In response to the COVID-19 crisis, the Commission introduced an amendment to the Common Provisions Regulation extending the possibility of using non-statistical sampling as an exceptional and temporary measure for the 2019/2020 accounting period. We found nonetheless that audit authorities had used statistical sampling for most of the 31 assurance packages in our sample (i.e. 87% of the packages, covering 190 of the 213 transactions).

**5.48.** However, we found gaps in the audit trail for the sampling of six assurance packages. Although this did not have an impact on representativeness, we consider that the audit authorities need to make sure that there is a complete and adequate audit trail for the sampling process.

---

21 The mission of Bulgaria's 'Audit of EU Funds' Executive Agency.

22 Regulation (EU) 2020/558 as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investment Funds in response to the COVID-19 outbreak.
Shortcomings remain in the way audit authorities perform and document their work

5.49. The *International Standards on Auditing* require auditors to document their checks, including clear references to all documents that are most relevant to the audited expenditure\(^ {23}\). This enables them to be accountable for their work and helps internal or external reviewers to conclude on the extent and sufficiency of the checks. Insufficient or inadequate questions or replies in checklists increase the risk of not detecting irregularities.

5.50. For 104 of the transactions in our sample (49 %), we were able to conclude on the basis of our review of the audit authorities’ work. We identified shortcomings in the scope, quality and/or documentation of that work in 109 transactions (51 %), which required us to re-perform the corresponding audit procedures. The main reason for the shortcomings was that the documentation stored in audit files was not always sufficient to allow an experienced auditor with no previous connection to the audit to reach the same conclusions as the original auditor. In the case of 43 transactions (20 % of the total) we were obliged to approach beneficiaries for the necessary audit documentation.

5.51. We found quantifiable errors that had not been previously identified by the audit authority in 25 of the 109 transactions (in 12 packages, including 11 for the 2014-2020 programming period) where we re-performed an audit.

5.52. In the same way as last year\(^ {24}\), during our review of audit authorities’ work we assessed whether the checklists they used to audit operations adequately addressed the risk of *fraud*. We found that 38 % of operations from the 2014-2020 period (81 out of 213) were audited using a checklist that explicitly addressed the risk of fraud, which is an improvement over the 21 % we found last year.

---

\(^ {23}\) ISA 230 Audit Documentation.

\(^ {24}\) Paragraphs 5.45 and 5.46 of the 2020 annual report.
The Commission’s assurance work and reporting of residual error rate in its annual activity reports

5.53. AARs are the Commission DGs’ main tool for reporting whether they have reasonable assurance that control procedures ensure the regularity of expenditure.

The Commission’s key performance indicator on regularity in annual activity reports is below materiality, while its estimate of maximum error is above

5.54. In cohesion, the Commission uses individual residual error rates reported by Member States, the results of its own regularity work and other available information to calculate a weighted average error rate. It reports that rate as a key performance indicator (KPI) on regularity. The KPI for 2021 is based on individual rates reported for the 2019/2020 accounting year, excluding the impact of advances paid to financial instruments. The Commission also calculates a maximum rate.

5.55. DG REGIO reported a KPI of 1.9 % and a ‘maximum rate’ of 2.5 %. The DG EMPL rates were 1.7 % for the KPI and 2.4 % for maximum risk. Both AARs explain that the maximum rates take account of audit results still under discussion with the Member States, and aims to address the risk of errors lying outside the sample of transactions in OPs which were audited during the year (either by the Commission or by us). Compared to previous years, the maximum rates may also include a ‘top-up’ or flat rate for unaudited OPs (see paragraph 5.62).

5.56. Figure 5.6 gives an overview of the KPIs reported by the Commission in its 2021 AARs.

25 Footnote 51 of DG REGIO 2021 AAR and footnote 73 of DG EMPL AAR.
5.57. In the 2021 AMPR, the Commission reported:

— For MFF heading 2 as a whole, a combined risk at payment of between 1.7 % and 2.3 %, basing this on the amounts at risk concluded by the various DGs. Our error range for MFF heading 2 is between 1.8 % and 5.4 %, with an estimated level of error of 3.6 %.

— For MFF subheading 2a on cohesion, a combined risk at payment of between 1.8 % and 2.5 %, again based on the DGs’ estimates for amounts at risk and their KPIs. Our error range for MFF subheading 2a is between 2.1 % and 6.1 %, with an estimated level of error of 4.1 %.

5.58. For the third year in a row, therefore, the Commission’s maximum error rates fall within our own error range estimates. Over the same period, the rates reported in the AMPR (and the specific rates reported in the AARs have been consistently below our estimate for the level of error (see Figure 5.6).

---

26 P. 21 of Volume III of the 2021 AMPR.
The Commission has improved its methodology for estimating maximum risk, but inherent risks remain in its assurance model

5.59. In 2021 we published a special report in which we provided details on the relevance, reliability and consistency of the annual level of error reported in AARs and the AMPR for cohesion expenditure. In 2021 we published a special report in which we provided details on the relevance, reliability and consistency of the annual level of error reported in AARs and the AMPR for cohesion expenditure.

5.60. The main conclusions of the report confirmed the last four years’ findings in our annual reports, in particular that:

— the Commission provides a minimum estimate for the level of error that is not final (at OP level, in AARs and in the AMPR);

— as desk reviews may fail to detect and correct irregular expenditure, they are of limited value in confirming the validity of the residual total error rates reported by audit authorities;

— the risk rating of audit authorities does not always influence whether they are selected for compliance audits;

— time constraints inherent to the control process mean that most OPs for which the Commission’s audit work gives rise to a material level of error were not covered by a reservation in the previous AAR.

5.61. In the same report we also observed that, where audit authorities gave a common error rate covering funds managed by two DGs, those DGs did not systematically coordinate their onward reporting. In this context, we have since taken note of the consistency achieved in the Commission’s audit and assessment work by the creation in July 2021 of the Joint Audit Directorate for Cohesion, which handles all audit activity in relation to cohesion expenditure.

5.62. In response to our recommendations, the Commission has revised its methodology for calculating maximum risks. In particular, it now applies a ‘top-up’ to unaudited OPs, based on error rates reported by the same audit authority for other OPs, or a flat rate if the audit authority has not yet been audited (see paragraph 5.55). However, the Commission does not make these adjustments in the case of OPs audited in earlier accounting years, for which it continues to rely on its desk reviews. As

---

27 Special report 26/2021: “Regularity of spending in EU Cohesion policy: Commission discloses annually a minimum estimated level of error that is not final”.

explained in paragraph 5.60, desk reviews have inherent limitations compared to compliance audits. Furthermore, the level of top-up may not be sufficient to account for errors that the Commission has not detected through its compliance audits.

The Commission continues to detect irregularities through its compliance audits

5.63. The reliability of the regularity information reported in AARs largely depends on the quality of programme authorities’ work. The Commission performs compliance audits to review and assess the work of audit authorities. The objective of these audits is to seek reasonable assurance that no serious weaknesses in management and control systems remain undetected and unreported – and therefore uncorrected – by the time the Commission receives the accounts.

5.64. In 2021, the Commission carried out 24 compliance audits, often covering ERDF/CF and ESF/YEI programmes. In 18 of these audits, the Commission concluded that the residual error rates reported in audit authorities’ annual control reports for the 2019/2020 accounting year were underestimated; the Commission therefore increased those rates. In 8 cases, this raised the residual rate above the 2 % materiality threshold.

No reference in annual activity reports to the ongoing rule of law procedure against Hungary

5.65. On 1 January 2021, the EU introduced a new regulation to protect its financial interests against breaches by Member States of the principles of the rule of law29. On 27 April 2022 the Commission sent Hungary a written notification concerning alleged breaches of the rule of law. According to the regulation, to do this the Commission must have reasonable grounds to consider that these breaches affect or seriously risk affecting the sound financial management of the EU budget or the EU’s financial interests. In their 2021 AARs, neither DG EMPL nor DG REGIO made any reference to this ongoing procedure or how it may affect the assurance that the Commission can obtain from Hungary’s control and assurance system.

29 Regulation (EU, Euratom) 2020/2092 on a general regime of conditionality for the protection of the Union budget.
Conclusion and recommendations

Conclusion

5.66. The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Cohesion, resilience and values’ was material. For MFF heading 2, our testing of transactions produced an estimated overall level of error of 3.6 %.

5.67. All the errors we have quantified in this chapter concern spending under subheading 2a for which our overall estimate is 4.1 %.

5.68. The control and assurance framework for cohesion spending in the 2014-2020 programming period was designed to ensure that annual residual error rates were below the materiality threshold. Our audit showed that further improvements are necessary in the way the framework is applied, both by the Member States’ programme authorities and by the Commission.

5.69. The number of errors reported by audit authorities, like our audit results, demonstrate that Member States’ management controls do not always effectively prevent or detect irregularities in the expenditure declared by beneficiaries.

5.70. Moreover, the weaknesses we found in the work of several audit authorities covered by our sample (see paragraphs 5.40-5.52) currently limit the reliance that can be placed on that work. The recalculated rate was above the 2 % materiality threshold in 12 out of 31 assurance packages for the 2014-2020 period. The Commission adjusted the residual error rates for nine of these 12 packages to a figure above 2 %. In doing this, it also took account of our audit work.

5.71. Since 2017, the assurance packages in our annual samples have consistently accounted for over one third of the expenditure accepted by the Commission. The share of expenditure covered by assurance packages with residual rates above 2 % has decreased from 55 % in 2018 to 39 % in 2021 (see Figure 5.4).

5.72. The regularity information presented in the AMPR for the 2019/2020 accounting year confirms that there was a material level of error in cohesion spending (2.5 %). Because of the issues reported in paragraph 5.60, both the Commission rates referred to in paragraph 5.55 must be considered minimum estimates. In this context,
we note that the Commission maximum rates fall in the lower half of our error range, and below our estimate for the level of error (see Figure 5.6).

5.73. In its AARs, the Commission (DG EMPL and DG REGIO) did not disclose any information about its ongoing rule of law procedure against Hungary, including how this may affect the assurance it can obtain about the regularity of expenditure from Hungary’s control and assurance system.

5.74. In connection with the transactions we audited under MFF subheading 2b, the Commission did not verify all the financial terms of its advance purchase agreements with manufacturers of COVID-19 vaccine doses. We also found procurement weaknesses under the Emergency Support Instrument. We have not quantified these errors, since in every case we examined the extraordinary nature of the pandemic supported direct contracting.

Recommendations

5.75. Annex 5.2 shows the findings of our follow-up review of the three recommendations we made in our 2018 annual report. Of these, the Commission had implemented two recommendations in full, while one had been implemented in most respects.

5.76. We consider recommendations 6.2 and 6.3 to have been implemented. We base this on the fact, that for recommendation 6.2 on the irregular withholding of payments, the Commission consistently checks that payments are made to beneficiaries on time and issues corrective recommendations to Member States as necessary. For recommendation 6.3 on 2014-2020 closure arrangements, the Commission has identified the main risks that affect the closure of programmes and has considered them when drafting closure guidelines.

5.77. We have also reviewed recommendations from the 2019 and 2020 annual reports that required immediate action or were targeted for implementation during 2021, as well as still relevant recommendations from the 2017 annual report that had not yet been fully implemented.

5.78. Based on this review and our findings and conclusions for 2021, we recommend that the Commission:
Recommendation 5.1 – Method used for reimbursing beneficiaries when SCOs are applied to determine the EU contribution to the programme

Reiterate to managing authorities the requirements attached to reimbursing beneficiaries using a methodology that differs from the simplified cost options (SCOs) used for calculating payments to Member States from the EU budget, taking particular account of the situation detected this year in Irish ESF operational programme.

Target implementation date: December 2022

Recommendation 5.2 – Contribution of national schemes to ESF objectives

Ensure that, when operational programmes are based on existing national schemes, the operation implemented contribute effectively to programme objectives, taking particular account of the situation detected this year in relation to NEET participants in Spanish ESF/YEI operational programmes.

Target implementation date: November 2022

Recommendation 5.3 – Verification of NEET status by programme authorities

Reiterate to programme authorities that they must confirm the NEET status of participants before submitting expenditure declarations for ESF/YEI programmes from the 2014-2020 period. These eligibility checks should be made on the basis of reliable and verified sources, taking particular account of the situation detected this year in French and Irish ESF/YEI OPs.

Target implementation date: December 2022
Recommendation 5.4 – Manufacturer compliance with advance purchase agreements for COVID-19 vaccines

Verify that COVID-19 vaccine manufacturers comply with the terms of advance purchase agreements, in particular as regards production cost estimates, the use of upfront financing and, where applicable, no-profit clauses, and take corrective action as necessary.

Target implementation date: December 2025

Recommendation 5.5 – Audit trail for sampling by audit authorities

Reiterate to audit authorities that the legal framework requires them to keep an audit trail, with which the Commission can verify that their sampling procedures are independent, objective and without bias.

Target implementation date: December 2022

Recommendation 5.6 – Rule of law

Provide information in its annual activity reports about ongoing rule of law procedures against Member States and how these may affect the assurance that the Commission can obtain about regularity of expenditure from the assurance and control systems of the countries concerned.

Target implementation date: April 2023 (next AARs)
Annexes

Annex 5.1 – Information on EU action in Member States and regions

<table>
<thead>
<tr>
<th>Member States</th>
<th>EU contribution (million euros)</th>
<th>Audited transactions 2014-2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>11 800</td>
<td>42</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3 245</td>
<td>14</td>
</tr>
<tr>
<td>Italy</td>
<td>3 002</td>
<td>15</td>
</tr>
<tr>
<td>Portugal</td>
<td>2 722</td>
<td>13</td>
</tr>
<tr>
<td>Spain</td>
<td>2 510</td>
<td>11</td>
</tr>
<tr>
<td>Romania</td>
<td>2 296</td>
<td>7</td>
</tr>
<tr>
<td>Germany</td>
<td>2 163</td>
<td>13</td>
</tr>
<tr>
<td>Hungary</td>
<td>1 826</td>
<td>9</td>
</tr>
<tr>
<td>Greece</td>
<td>1 666</td>
<td>9</td>
</tr>
<tr>
<td>France</td>
<td>1 560</td>
<td>7</td>
</tr>
<tr>
<td>Lithuania</td>
<td>1 490</td>
<td>8</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1 070</td>
<td>7</td>
</tr>
<tr>
<td>Territorial cooperation</td>
<td>1 356</td>
<td>9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1 040</td>
<td>8</td>
</tr>
<tr>
<td>Croatia</td>
<td>897</td>
<td>7</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>838</td>
<td>7</td>
</tr>
<tr>
<td>Estonia</td>
<td>544</td>
<td></td>
</tr>
<tr>
<td>Latvia</td>
<td>465</td>
<td></td>
</tr>
<tr>
<td>Slovenia</td>
<td>384</td>
<td>7</td>
</tr>
<tr>
<td>Finland</td>
<td>256</td>
<td>5</td>
</tr>
<tr>
<td>Belgium</td>
<td>251</td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>203</td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>134</td>
<td>5</td>
</tr>
<tr>
<td>Ireland</td>
<td>117</td>
<td>5</td>
</tr>
<tr>
<td>Netherlands</td>
<td>75</td>
<td>4</td>
</tr>
<tr>
<td>Malta</td>
<td>73</td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>55</td>
<td></td>
</tr>
<tr>
<td>Cyprus</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Luxembourg</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>40 738</strong></td>
<td><strong>212</strong></td>
</tr>
</tbody>
</table>

NOTE: Territorial cooperation contributions, which are transnational, are not included in this illustration.

Source: ECA
Annex 5.2 – Follow-up of previous recommendations for ‘Cohesion, resilience and values’

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2017</td>
<td>We recommend that the Commission: Recommendation 1: ensure that the audit arrangements for financial instruments managed by the EIF are adequate at the level of financial intermediaries. When the EIB/EIF uses agreed-upon procedures with external auditors, the Commission should define the minimum conditions of such contracts with a view to the need to provide</td>
<td>x&lt;sup&gt;30&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

<sup>30</sup> The Omnibus Regulation introduced a requirement for audit authorities to perform system audits and audits of operations on financial instruments at the level of financial intermediaries, including financial instruments managed by the EIB Group but excluding SME Initiative programmes set up before 2 August 2018. The Commission has taken additional measures by including, in the audit methodology for financial instruments, a recommendation that audit authorities audit financial intermediaries for instruments implemented by the EIB Group, regardless of when they were set up. However, the methodology cannot extend the regulatory mandate of audit authorities. The Commission provided proof that in some Member States the audit authorities already perform checks at the level of the financial intermediaries. However, our 2020 audit revealed that those checks are not yet performed consistently (in the Member State we audited, neither the external auditor nor the audit authorities carried out any audit at the level of financial intermediaries). No new elements were provided to show that this was corrected in 2021.
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>assurance, in particular the obligation for sufficient audit work at the level of the Member State; (Implementation date: immediate)</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 3</strong>: address the weaknesses we have identified in its verification of the audit authorities’ work in the context of the Commission’s regularity audits; (Implementation date: immediate)</td>
<td>X&lt;sup&gt;31&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 4</strong>: address the complexity of the information presented on the 2014-2020 control and assurance framework in the AARs of DGs REGIO and EMPL, by: (iii) disclosing an overall residual error rate for MFF subheading 1b for each accounting year. (Implementation date: June 2019)</td>
<td>X&lt;sup&gt;32&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

<sup>31</sup> See paragraphs 6.58-6.64 of the 2018 annual report and 5.48-5.62 of the 2019 annual report and paragraphs 5.43-5.44 of the 2020 annual report. Despite the Commission’s increased compliance audit work, we still encounter weaknesses in the audit authorities’ work.

<sup>32</sup> Point (iii) is implemented in most respects since in the 2020 AMPR the Commission provided an overall residual error rate for the policy area which did not fully correspond to MFF subheading 1b. For the new MFF headings, the overall residual error rate should be presented at least for subheading 2a.
### ECA’s analysis of the progress made

<table>
<thead>
<tr>
<th>ECA recommendation</th>
<th>Fully implemented</th>
<th>Implemented In most respects</th>
<th>Implemented In some respects</th>
<th>Not Implemented</th>
<th>Not applicable</th>
<th>Insufficient evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Recommendation 5:</strong> ensure that audit arrangements are changed in accordance with the proposal made by the Commission for financial instruments in the post-2020 regulatory framework so that only the actual use of funds at final recipient level is used for the calculation of residual error rates. (Implementation date: before implementation of the post-2020 legislative framework begins)</td>
<td></td>
<td></td>
<td>X&lt;sup&gt;33&lt;/sup&gt;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Recommendation 6:</strong> carry out sufficient regularity checks to conclude on the effectiveness of audit authorities’ work and obtain reasonable assurance on the regularity of expenditure at the latest in the AARs it publishes following the year of accepting the accounts; (Implementation date: immediate)</td>
<td></td>
<td>X&lt;sup&gt;34&lt;/sup&gt;</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>33</sup> The new common provisions regulation for the 2021-2027 period (Regulation (EU) 2021/1060) provides for a single advance payment for financial instruments to be included in the first payment application. In its replies to the follow-up for the 2020 annual report, the Commission stated its intention to adopt a delegated act requiring audit authorities to exclude this advance from the audit population. The Commission has now reassessed this position and stated that the initial advance will remain part of the audited population for the accounting year concerned.

<sup>34</sup> See paragraph 5.64 of this annual report.
### Year | ECA recommendation |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>We recommend that the Commission:</td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 6.1 - Audit arrangements for SME Initiative programmes</strong></td>
</tr>
<tr>
<td></td>
<td>Ensure that:</td>
</tr>
<tr>
<td></td>
<td>(a) regular checks, based on a representative sample of disbursements to final recipients, are carried out at the level of financial intermediaries either by the audit authority or by an auditor selected by the EIB Group;</td>
</tr>
<tr>
<td></td>
<td>(b) where such checks were insufficient, develop and implement appropriate control measures to prevent the possibility of material irregular expenditure at closure.</td>
</tr>
<tr>
<td></td>
<td>(Target implementation date: immediate)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2018</td>
<td></td>
</tr>
</tbody>
</table>

¹³⁵ Our previous audits confirmed that the EIF has already made or is making improvements to its monitoring and control systems and has voluntarily extended the use of reasonable assurance reports to SMEI programmes. While we acknowledge that some audit authorities have already carried out verifications at the level of financial intermediaries, the full effectiveness of these measures has not yet been proven.
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
<th>Fully implemented</th>
<th>Implemented</th>
<th>Not Implemented</th>
<th>Not applicable</th>
<th>Insufficient evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Common Provisions Regulation, which states that beneficiaries must receive the total amount of eligible expenditure due no later than 90 days from the date of submission of the related payment claim. Where relevant, make appropriate recommendations to programme authorities and encourage them to follow correct practice in the future. (Target implementation date: immediate)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
|      | **Recommendation 6.3 – 2014-2020 closure arrangements**  
Address weaknesses and ensure that no programme can be closed with a material level of irregular expenditure. The Commission should:  
(a) identify the main risks that may affect the regular closure of programmes;  
(b) where appropriate, develop targeted guidance on the arrangements for closure which includes adequate and timely corrective measures. (Target implementation date: (a) May 2020 and (b) December 2022) |                                                                                                                                                                                                                                                                                                                                                                     | X                 |             |                 |                 |                      |
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2019</td>
<td>We recommend that the Commission:</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 5.1 - Project eligibility conditions</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Clarify what is meant by ‘physically completed’ and/or ‘fully implemented’ operations. This would help Member States to verify that operations comply with Article 65(6) of the CPR and avoid the non-detection of ineligible operations. It should be made clear that this condition relates only to works or activities necessary to achieve the operation’s output, and not to financial and administrative aspects.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Timeframe: immediate)</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 5.2 – Action to increase the reliability of the residual rates reported by audit authorities</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Analyse the main sources of undetected errors and develop the necessary measures together with audit</td>
<td></td>
</tr>
</tbody>
</table>

36 We acknowledge the measures which the Commission has already initiated in order to clarify the concepts of ‘physically completed’/’fully implemented’ operations. However, the Commission has not disseminated those clarifications to all Member States.

37 Despite the Commission’s efforts, as presented in the AARs of DG REGIO (2019: p. 25 and 2020: pp. 41-43) and DG EMPL (2019: p. 4), our audit work for 2020 did not show a significant improvement in this respect (see for example paragraph 5.38 of the 2020 annual report and paragraphs 5.40 and 5.41 of this year’s report.
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td>authorities to improve the reliability of reported residual rates.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Timeframe: June 2021)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Closely monitor Member States using its standard scales of unit costs, to ensure</td>
<td></td>
</tr>
<tr>
<td></td>
<td>that the scheme does not result in excessive imbalances in favour of Member States,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Commission should ask Member States to adjust excessive rates and correct</td>
<td></td>
</tr>
<tr>
<td></td>
<td>imbalances to avoid any gains at programme closure. (Timeframe: immediate)</td>
<td>X</td>
</tr>
</tbody>
</table>

*Source: ECA*
Chapter 6

Natural resources and environment
Contents

Brief description 6.2.-6.11.
Policy objectives and spending instruments 6.2.-6.4.
Main spending categories 6.5.-6.11.
Audit scope and approach 6.12.

Results of transaction testing 6.14.-6.27.
Direct payments: lower risk of error 6.18.-6.20.
Rural development, market measures and other payments: higher risk of error 6.21.-6.27.
Checks by monitoring – an effective tool for paying agencies’ checks 6.28.-6.35.
Coherence checks of Member States’ control statistics and payments data 6.36.-6.37.
Rural development measure M21: emergency support allocated to those beneficiaries in need, but with some exceptions 6.38.-6.40.

Annual activity reports and other governance arrangements 6.41.-6.46.
DG AGRI and DG CLIMA reporting on the regularity of spending 6.41.-6.45.
The Commission’s Annual Management and Performance Report (AMPR) 6.46.

Conclusion and recommendations 6.47.-6.51.
Conclusion 6.47.-6.48.
Recommendations 6.49.-6.51.
Annexes

Annex 6.1 – Information on EU action in Member States and the UK

Annex 6.2 – Follow-up of previous recommendations
Introduction

6.1. This chapter presents our findings for MFF heading 3 ‘Natural resources and environment’ (MFF3). Figure 6.1 gives an overview of the main activities and spending under this heading in 2021.

Figure 6.1 – Payments and audit population

2021 payments breakdown by fund

European Agricultural Guarantee Fund - direct payments 38.3 (67.3 %)
Agricultural Fund for Rural Development 14.6 (25.7 %)
European Agricultural Guarantee Fund - market related expenditure 2.5 (4.5 %)
Maritime and Fisheries 0.9 (1.6 %)
Environment and Climate (LIFE) 0.4 (0.7 %)
Others 0.1 (0.2 %)

2021 audit population compared to payments

2021 payments – total 56.8

Interim and final payments: 56.3
Pre-financing payments (*): 0.5

2021 audit population – total 56.6

Interim and final payments: 56.3
Clearing of pre-financing (*): 0.3

(*) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

Source: ECA, based on data 2021 from the consolidated accounts of the European Union.
Policy objectives and spending instruments

6.2. Agriculture and rural development account for 97% of spending on ‘Natural resources and environment’ and are implemented through the *common agricultural policy* (CAP). The CAP has three general objectives:\1:

- viable food production, with a focus on agricultural income, agricultural productivity and price stability;
- the sustainable management of natural resources and climate action, with a focus on greenhouse gas emissions, biodiversity, soil and water;
- balanced territorial development.

6.3. While the European Commission, in particular the Directorate-General for Agriculture and Rural Development (DG AGRI), is ultimately responsible for the CAP, it shares its management with *paying agencies* in the Member States. Since 2015, independent *certification bodies* in the Member States provide annual opinions on the *legality and regularity* of the expenditure.

6.4. CAP spending falls into three broad categories:

- *direct payments* to farmers, fully funded by the EU budget;
- Member States’ national and regional *rural development programmes*, co-financed by the EU budget and the Member States;
- agricultural *market measures*, also fully funded by the EU budget, with the exception of certain measures co-financed by the Member States, including promotion measures.

---

1 Article 110(2) of *Regulation (EU) No 1306/2013* on the financing, management and monitoring of the common agricultural policy.
Main spending categories

6.5. Direct payments account for 67% of spending under MFF3. Four schemes account for 89% of all direct payments in 2021:

- two providing income support based on the area of agricultural land declared by farmers: the ‘basic payment scheme’ (€14.8 billion) and the ‘single area payment scheme’ (€4.4 billion);
- one intended to support agricultural practices beneficial for the climate and the environment: the ‘greening payment’ (€10.8 billion);
- one linked to specific types of agricultural produce (e.g. beef and veal, milk or protein crops): ‘voluntary coupled support’ (€4.0 billion).

6.6. Direct payments to farmers are entitlement-based: beneficiaries receive payment if they meet certain conditions. Such payments carry a lower risk of error than reimbursement-based payments, provided the attached conditions are not complex (see paragraph 1.18).

6.7. Rural development accounts for 26% of spending under this MFF heading. The Commission approved 118 rural development programmes in the Member States for 2014 - 2020, consisting of 20 measures and 67 sub-measures. A further measure was added in 2020 (M21 ‘Exceptional temporary support to farmers and SMEs particularly affected by the COVID-19 crisis’). The first Commission disbursement based on Member States’ declared expenditure under the new measure M21 took place in 2021. 14 Member States declared expenditure under this measure, amounting to a total of €616.3 million. Following delays in adopting the legislation for the post - 2020 CAP, the programmes have been extended until the end of 2022.

---

2 Regulation (EU) 2020/872 amending Regulation (EU) No 1305/2013 as regards a specific measure to provide exceptional temporary support under the European Agricultural Fund for Rural Development (EAFRD) in response to the COVID-19 outbreak.

3 In our sample we hit seven measure M21 transactions, for which we did not report any error.

4 Under the United Kingdom Withdrawal Agreement, the former Member State’s rural development programmes will run until their closure in 2023.
6.8. Rural development spending falls into two broad categories:

- payments to farmers based on environmental and climate-related criteria applied to the agricultural area or on the number of animals on the holding (‘area/animal-related’);
- aid to investment projects intended to support social and economic development in rural areas (‘non-area-based’).

6.9. Agricultural market measures, which account for 4.4 % of MFF3 spending, form a number of diverse schemes (e.g. promotion of agricultural products, fruit and vegetables in schools, producer organisations) subject to a variety of eligibility conditions.

6.10. This MFF heading also covers EU spending on the maritime and fisheries policy, and part of the EU spending on the environment and climate action covering EMFF and LIFE programmes. This spending category (2.2 % of MFF3 spending) also involves a variety of selection criteria, eligibility requirements and disbursement methods.

6.11. The eligibility conditions for most spending on rural development, market measures and the other MFF3 policy areas outside the CAP are more complex than for direct payments, and the risk of error is higher (see paragraph 1.18).
Audit scope and approach

6.12. Our objective was to estimate the level of error for this MFF heading and to contribute to the statement of assurance. Applying the audit approach and methods set out in Annex 1.1, we examined the following for this MFF heading in 2021:

(a) a statistically representative sample of 212 transactions covering the full range of spending under this MFF heading:

(i) 84 direct payments, covering the main schemes;

(ii) 42 area/animal-related transactions under rural development programmes;

(iii) 62 non-area-based rural development transactions, 14 transactions related to market measures, and 10 transactions\(^5\) under spending areas outside the CAP.

(b) the regularity information given in the annual activity reports of DG AGRI and DG CLIMA and then included in the Commission’s Annual Management and Performance Report (AMPR).

(c) selected systems, under which we checked the Member States’ implementation of ‘checks by monitoring’ and of measure M21, and carried out coherence checks of control statistics and payment data submitted by the Member States to the Commission.

\(^5\) We audited seven transactions under the European Maritime and Fisheries Fund and three transactions related to the LIFE programme for the environment and climate action.
Regularity of transactions

6.13. This part of the chapter consists of four sub-sections. The first sub-section concerns our testing of this year’s sample of 212 transactions and aims to provide insight on the main sources of error. The second sub-section concerns our examination of the Member States’ implementation of checks by monitoring. The third concerns our checks on control and payment data reported by the paying agencies, while in the fourth subsection we describe our audit findings on selected Member States’ implementation of measure M21.

Results of transaction testing

6.14. The 212 transactions we audited cover 18 Member States. We audited direct payments in 14 Member States, and our testing of rural development transactions covered 20 national and regional programmes in 14 Member States. Of the 212 transactions we examined, 185 (87%) were error-free and 27 (13%) contained errors. Based on the 23 errors we have quantified (see Figure 6.2) and other evidence produced by the control system (see section on “Annual activity reports and other governance arrangements”), we find the level of error for ‘Natural resources’ to be close to the materiality threshold. The majority of the errors we found affected rural development and market measures transactions. We found a few minor quantified errors in direct payments. We also found four compliance issues without financial impact.

6 Belgium, Bulgaria, Denmark, Germany, Ireland, Greece, Spain, France, Croatia, Italy, Latvia, Lithuania, Hungary, Austria, Poland, Portugal, Romania, Finland.
6.15. Annex 6.1 presents an overview of MFF3 payments and the results of our transaction testing.

6.16. Figure 6.3 gives a breakdown of our estimated level of error for 2021, by category of error.

Figure 6.3 – The most common source of errors found was ineligible beneficiaries or expenditure

Source: ECA.
6.17. The Member State authorities and the Commission (for direct management) had applied corrective measures that directly affected 21 of the transactions we sampled. These measures were relevant to our calculations, as they reduced our estimated level of error for this chapter by 0.3 % percentage points. In 15 cases of quantifiable errors, the Member State authorities and the Commission had sufficient information to prevent, or to detect and correct, the error before accepting the expenditure. Had the Member State authorities and the Commission (for direct management) made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 1.2 percentage points lower. Box 6.1 shows an example of an administrative error due to the failure to use available information.

**Box 6.1**

A paying agency failed to use all available information when checking a beneficiary’s declared costs

Wine promotion measure, Spain

- Under the national rules, beneficiaries organising wine tastings can only claim reimbursement for the costs of one bottle of each type of wine for every six participants.

- The paying agency requested a comprehensive report from the beneficiary listing the events organised and the number of participants and bottles for each event.

- When performing checks on the eligibility of costs declared, the paying agency focused on other checks, and failed to notice that this requirement had not been met, even though the beneficiary had submitted the relevant information to the paying agency.

In our audit of the transaction, we were provided with the correct recalculated number of bottles that could have been claimed. This resulted in a deduction of almost 50 % of the wine bottles initially claimed, leading to an error of 6.5 % in the beneficiary’s total declared costs for the action.
Direct payments: lower risk of error

6.18. In the 84 direct payment transactions tested, we found only three minor quantifiable errors, which resulted from farmers overstating the eligible area of agricultural land.

6.19. Direct payments are managed through the Integrated Administration and Control System (IACS)\(^7\), which incorporates the Land Parcel Identification System (LPIS). IACS interlinks databases of holdings, aid applications, agricultural areas and animal registries, which the paying agencies use to perform administrative cross-checks\(^8\) on all aid applications. The LPIS is a geographical information system containing multiple-source spatial data sets, which together form a record of agricultural areas in the Member States. The use of preliminary checks by paying agencies since 2015 and the introduction of ‘checks by monitoring’ in some Member States in 2018 give beneficiaries the possibility to correct certain errors in their aid applications, reducing the risk of error.

6.20. Our findings confirm our previous observations\(^9\) that IACS, and the LPIS in particular, form an effective management and control system to ensure that direct payments as a whole are not affected by material error.

Rural development, market measures and other payments: higher risk of error

Area/animal-related rural development spending

6.21. We examined 42 rural development payments based on the area or animal numbers declared by farmers. These include compensation payments for organic farming, payments to farmers in areas with natural constraints and payments for meeting specific agri-environment-climate commitments.

---

\(^7\) [https://ec.europa.eu/agriculture/direct-support/iacs_en](https://ec.europa.eu/agriculture/direct-support/iacs_en)


\(^9\) 2020 annual report, paragraph 6.16.
6.22. Of the 42 area or animal-related rural development transactions we tested, 35 were unaffected by error. We found six quantifiable errors, three of which were over 20%, and one compliance issue without financial impact.

6.23. Two of the quantified errors occurred because a paying agency had made payments based on inaccurate data on beneficiaries recorded in its animal database. For the remaining four findings, the sources of error are breaches of animal welfare and agri-environment-climate commitments (see example in Box 6.2) and an overdeclaration of the eligible area.

Box 6.2

Example of non-compliance with agri-environment-climate eligibility condition

In Poland, a farmer received aid under rural development measure M10 ‘Agri-environment-climate’. The farmer declared three parcels of land under the measure and had to respect several commitments:

- mow the declared areas once between 15 June and 30 September;
- on two of the parcels, leave 15-20% of the area unmown; and
- collect or put into bales the mown biomass within two weeks of mowing.

We found that most of the data recorded in the beneficiary’s farm register did not reflect the actual agricultural activity. Using evidence from Sentinel satellite images, we were able to establish that:

- one parcel was not mown at all;
- one of the parcels which should have been left partly unmown was completely mown; and
- on two parcels, the mowing date was different than that recorded by the farmer, which led us to conclude that the mown biomass was collected or put into bales more than two weeks after mowing.

Taking into account the penalties laid down in the national rules, these non-compliances led to an error of 57% for the audited payment.
Investment projects

6.24. We examined 62 rural development payments to investment projects, such as the modernisation of farms, construction of farming or processing facilities for agricultural products, support for basic services and village renewal in rural areas, or the setting-up of young farmers.

6.25. We quantified errors in seven payments to investment projects, mostly resulting from beneficiaries declaring expenditure or activities that did not meet the eligibility conditions. In four cases, the errors were minor, while in the other three cases they exceeded 20%.

Market measures

6.26. We tested 14 market measures transactions and found four cases in which paying agencies had reimbursed ineligible costs. All four errors were below 20%.

Maritime, fisheries, the environment and climate action

6.27. For the maritime, fisheries, the environment and climate action areas, we audited four direct management transactions and we found no error. For the remaining six transactions, which are under shared management, we found three quantified errors, including one above 20%, resulting from the incorrect calculation of eligible costs.

Checks by monitoring – an effective tool for paying agencies’ checks

6.28. Since 2018, Member State paying agencies may perform ‘checks by monitoring’. This approach uses automated processes based on the EU Copernicus programme’s Sentinel satellite data to check compliance with certain CAP rules. In 2021, 10 Member States mainly used checks by monitoring to assess area-based aid claims under direct payment schemes. Where all the eligibility criteria of a given payment scheme can be evaluated from space, paying agencies can monitor the whole population of aid recipients remotely.

6.29. Checks by monitoring provide regular observations of agricultural activity and can be used to warn farmers of potential non-compliance with the payment scheme rules at any time during the growing season. This provides farmers with more opportunities to rectify their claims before they are finalised.
6.30. The map below shows which Member States/regions are using checks by monitoring.

Figure 6.4 – Countries and regions applying ‘checks by monitoring’

<table>
<thead>
<tr>
<th>Member States and regions officially applying ‘checks by monitoring’ in 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
</tr>
<tr>
<td>Flemish Region, Walloon Region</td>
</tr>
<tr>
<td>Denmark</td>
</tr>
<tr>
<td>– whole country</td>
</tr>
<tr>
<td>Germany</td>
</tr>
<tr>
<td>Baden-Württemberg, Schleswig-Holstein, Saxony-Anhalt</td>
</tr>
<tr>
<td>Ireland</td>
</tr>
<tr>
<td>– whole country</td>
</tr>
<tr>
<td>Spain</td>
</tr>
<tr>
<td>Andalusia, Aragon, Asturias, Balearic Islands, Basque Country, Cantabria, Castile and Leon, Castile-la Mancha, Catalonia, Extremadura, Galicia, Madrid, Murcia, Navarre, Rioja, Valencia</td>
</tr>
<tr>
<td>Croatia</td>
</tr>
<tr>
<td>– whole country</td>
</tr>
<tr>
<td>Italy</td>
</tr>
<tr>
<td>Latvia</td>
</tr>
<tr>
<td>– whole country</td>
</tr>
<tr>
<td>Malta</td>
</tr>
<tr>
<td>– whole country</td>
</tr>
<tr>
<td>Portugal</td>
</tr>
<tr>
<td>– whole country</td>
</tr>
</tbody>
</table>

Source: Created with “Tableau” by ECA based on Commission data, map background ©Mapbox and ©OpenStreetMap licensed under the Creative Commons Attribution-Share Alike 2.0 licence (CC BY-SA).

6.31. In our recent special report on the use of new imaging technologies to monitor the CAP, we recommended that the Commission promote checks by monitoring as a key control system for the post-2020 CAP and help the Member States to make better use of new technologies for monitoring environmental and
climate requirements\textsuperscript{10}. In our special report on fraud in the CAP, we recommended that the Commission promote the use of new technologies in preventing and detecting fraud in CAP spending\textsuperscript{11}.

6.32. During our 2021 Statement of Assurance work, we examined the implementation of checks by monitoring in Spain and Italy.

6.33. Spain has been implementing ‘checks by monitoring’ via national and regional monitoring projects for direct payments since 2019. These concerned 14 regions in 2020 and 15 in 2021, out of 17 in total. Some regions have extended this approach to an increasing number of rural development measures, covering three measures in 2020 and 11 in 2021. \textit{Box 6.3} shows an example of the application of checks by monitoring to a rural development agri-environment measure.

\begin{center}
\textbf{Box 6.3}
\end{center}

\textbf{‘Checks by monitoring’ applied to an agri-environment measure in Spain (Andalusia) in 2021}

We analysed the application of checks by monitoring in Andalusia.

The paying agency had conducted its own combined checks by monitoring project for coupled support for rice (direct payment) and the rural development measure ‘Agricultural systems of particular interest to the birds of Andalusian rice fields’. The checks involved eight weeks of monitoring via satellite imagery to verify whether the requirements for winter flooding of the rice fields had been met. Once the production cycle of the crop is finished, the rice fields are required to remain flooded until 15 January of the following year in order to help preserve ornithological biodiversity.

\textsuperscript{10} \textit{Special report 04/2020}: “Using new imaging technologies to monitor the Common Agricultural Policy: steady progress overall, but slower for climate and environment monitoring”, paragraph 82.

\textsuperscript{11} \textit{Special report 14/2022}: “The Commission’s response to fraud in the Common Agricultural Policy: Time to dig deeper”, paragraph 112.
6.34. In Italy, two out of the 11 paying agencies used checks by monitoring in 2021 (AGEA and ARCEA). The coverage has increased from 17 to 29 municipalities compared to the previous year, reaching 2.9 million ha. The checks covered only direct payments, but Italy intends to extend the checks to some rural development measures (e.g. maintenance of soil cover in permanent crops, direct sowing or minimum tillage). The national authorities indicated as an improvement of the system the use of satellite images with better resolution, and more detailed and accurate data in the farmers’ claims about the crops and the agricultural practices.

<table>
<thead>
<tr>
<th>Sentinel 2 images taken on</th>
<th>Source: ECA.</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 and 28 September, 13 October</td>
<td>Source: Copernicus Sentinel data (2021) processed by Sentinel Hub and the Andalusian paying agency.</td>
</tr>
<tr>
<td>(before flooding period)</td>
<td></td>
</tr>
<tr>
<td>23 October, 7 and 17 November</td>
<td></td>
</tr>
<tr>
<td>(during flooding period)</td>
<td></td>
</tr>
</tbody>
</table>

The images below show post-harvest flooding in the rice fields, which we confirmed during an on the spot visit in November 2021.
6.35. The Commission has committed itself to providing support to the Member States in developing checks by monitoring. At the end of 2021, the area of the main direct aid schemes (basic payments and single area payments) subject to checks by monitoring was 13.1%.

Coherence checks of Member States’ control statistics and payments data

6.36. Each year, Member States submit to the Commission data on their checks of aid payments (‘control statistics’), as well as data on the payments made to beneficiaries. We examined for the financial year 2021, the quality and coherence of these control statistics and payment data reported by the 13 paying agencies selected in our direct payments sample. These data are the basis on which the Commission reimburses EU funds to the Member States.

6.37. We found some inconsistencies between the control and payment data, which were largely due to the timing mismatch between the two datasets. While the control data are static, prepared as of 15 July 2021, the paying agencies continuously update the payment data. The updates are based on changes on the beneficiary side (for example, holding transfers) or on the agency side (as a result of its checks). Despite this inherent obstacle, we achieved a very high level of accuracy for the recalculation of payment data. Overall, we found that the selected paying agencies’ systems reliably calculated the aid payments, correctly taking into account adjustments resulting from the control data.

---

12 Commission replies to special report 04/2020.

**Rural development measure M21: emergency support allocated to those beneficiaries in need, but with some exceptions**

**6.38.** The main purpose of measure M21 was to address liquidity problems for farmers and *small and medium-sized businesses* active in processing, marketing or development of agricultural products particularly affected by the COVID-19 crisis, aiming to ensure continuity of their business activity. We examined the implementation of the measure in four Member States (Bulgaria, Greece, Poland and Romania). We checked if the two main conditions for support were respected, namely that the aid applications should be approved by the competent authority by 31 December 2020 and that the maximum amount of support should not exceed €7 000 per farmer and €50 000 per SME\(^\text{14}\).

**6.39.** We found that, in general, the conditions for support laid down in the regulation were respected. We noted that the conditions for accessing this aid were less demanding than for other type of direct aids. Given the urgent nature of measure M21, most of the Member States managed this measure outside their IACS system.

**6.40.** We identified a limited number of cases where beneficiaries who did not meet the criteria for support received funds. This could have been prevented by the paying agencies, if they had used the IACS system instead of managing these measures outside automatic checks, using Excel sheets.

---

\(^{14}\) Article 39b (4) and (5) of Regulation (EU) 1305/2013.
Box 6.4

Examples of beneficiaries not meeting the criteria of measure M21

In Romania and Bulgaria, payments were made to entities that are not dependent on agricultural activity, for example monasteries, churches, prisons, public research institutes or NGOs. This category of beneficiaries has not suffered from liquidity and cash-flow problems to an extent that would justify the granting of exceptional aid.

In Poland we found a few cases of poultry farms that submitted more than one application. In most cases a married couple each claimed the maximum aid of €7 000, stating that they should be treated as separate farmers, even though their animals occupy the same buildings. The paying agency approved support based only on documentary evidence, without farm visits to verify the actual separation of agricultural activities between family members.
Annual activity reports and other governance arrangements

DG AGRI and DG CLIMA reporting on the regularity of spending

6.41. Each paying agency director provides DG AGRI with an annual management declaration on the *effectiveness* of their agency’s management and control systems, and the legality and regularity of their expenditure. In addition, the Member States report annually on their administrative and on-the-spot checks (‘control statistics’).

6.42. Since 2015, in order to provide additional assurance, certification bodies have been required to give an annual opinion for each paying agency on the legality and regularity of the expenditure for which Member States have requested reimbursement.

6.43. DG AGRI uses the error rates reported in the control statistics, making adjustments based on the results of the certification bodies’ audits, and its own audits of paying agencies’ systems and spending, to calculate a figure for ‘risk at payment’ for direct payments, rural development and market measures. The adjustments stemming from DG AGRI’s own analysis result in one-off or flat-rate corrections. Application of flat-rates facilitates standard treatment of issues identified in the Member States’ management and control systems. DG AGRI deducts its estimate of future financial corrections and recoveries from the ‘risk at payment’ to estimate a ‘final amount at risk’.

6.44. The control statistics reported by the paying agencies indicated a level of error equivalent to 0.9 % of CAP spending as a whole. DG AGRI, taking into account the work of the certification bodies and its own audits, calculated the ‘estimated amount at risk at payment’ to be €1 020,68 million, i.e. around 1.8 % of the CAP expenditure as a whole in 2021. DG AGRI estimated a risk at payment (adjusted error rate) of around 1.4 % for direct payments, 2.9 % for rural development and 2.1 % for market measures. The regularity information provided in DG AGRI’s annual activity report is in line with our findings and conclusions, and consistent with the knowledge we obtained from the audit.
6.45. We performed a limited review of the regularity information in DG CLIMA’s annual activity report. Based on our limited review, we noted that the methodology for the calculation of the final risk at payment (or closure) was in line with the Commission guidelines.

The Commission’s Annual Management and Performance Report (AMPR)

6.46. The Commission’s estimate of risk at payment for ‘Natural resources’ presented in its AMPR is 1.8 %.
Conclusion and recommendations

Conclusion

6.47. The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Natural resources and environment’ was close to materiality (see paragraph 6.14). For this MFF heading, our testing of transactions produced an estimated overall level of error of 1.8%.

6.48. Our results indicate that the level of error was not material for direct payments, representing 67% of spending under this MFF heading, while it was, taken as a whole, still material for the spending areas we had identified as higher risk (rural development, market measures, maritime, fisheries, the environment and climate action) representing 33% of spending.

Recommendations

6.49. The paying agencies are required to have systems in place to prevent and detect fraud, and the Commission must obtain reasonable assurance on the operation of those systems. In our 2019 annual report, we identified some weaknesses in CAP anti-fraud policies and procedures, and made a recommendation to tackle the issues\(^{15}\). Annex 6.2 shows the findings of our follow-up review of the recommendation we made in our 2019 annual report.

6.50. We consider the recommendation as implemented in some respects due to the fact that the Commission has taken some actions to address the issues we identified. In our recent special report on fraud in the CAP, we have reiterated these recommendations. We set target implementation dates of 2023 for the analysis of fraud risks and of Member States’ fraud prevention measures, and 2024 for promoting the use by more paying agencies of the Arachne data-mining and risk-scoring tool.

\(^{15}\) 2019 annual report, paragraphs 6.34-6.41 and 6.44.
6.51. Based on this review and our findings and conclusions for 2021, we recommend that the Commission:

**Recommendation 6.1 – Support the use of new technologies for preventing errors in CAP payments**

Based on the experience of the use of ‘checks by monitoring’, facilitate the sharing of best practices in Member States’ use of new technologies for performing their checks of CAP payments, in order to support the Member States in their implementation of the Area Monitoring System from 2023.

**Target implementation date: 2023**

**Recommendation 6.2 – Checks of measure M21 payments**

Perform audits, and ensure monitoring and evaluation, to confirm that measure M21 funding properly targeted eligible beneficiaries suffering liquidity problems which put at risk the continuity of their farming or business activities.

**Target implementation date: 2023 for auditing; 2025 for monitoring and evaluation**
Annex 6.1 – Information on EU action in Member States and the UK

<table>
<thead>
<tr>
<th>Member States</th>
<th>Total payments</th>
<th>Direct payments</th>
<th>Rural development</th>
<th>Other</th>
<th>Audited transactions</th>
<th>Quantifiable errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>9 339</td>
<td>544</td>
<td>6 808</td>
<td>1 915</td>
<td>73</td>
<td>25</td>
</tr>
<tr>
<td>Spain</td>
<td>6 905</td>
<td>611</td>
<td>5 057</td>
<td>1 149</td>
<td>88</td>
<td>17</td>
</tr>
<tr>
<td>Germany</td>
<td>6 114</td>
<td>125</td>
<td>4 615</td>
<td>1 354</td>
<td>20</td>
<td>28</td>
</tr>
<tr>
<td>Italy</td>
<td>5 730</td>
<td>683</td>
<td>3 557</td>
<td>1 471</td>
<td>20</td>
<td>18</td>
</tr>
<tr>
<td>Poland</td>
<td>4 821</td>
<td>32</td>
<td>3 320</td>
<td>1 419</td>
<td>51</td>
<td>18</td>
</tr>
<tr>
<td>Romania</td>
<td>3 174</td>
<td>62</td>
<td>1 885</td>
<td>1 215</td>
<td>11</td>
<td>16</td>
</tr>
<tr>
<td>Greece</td>
<td>2 725</td>
<td>50</td>
<td>1 991</td>
<td>636</td>
<td>48</td>
<td>9</td>
</tr>
<tr>
<td>Hungary</td>
<td>1 892</td>
<td>34</td>
<td>1 276</td>
<td>577</td>
<td>5</td>
<td>14</td>
</tr>
<tr>
<td>Ireland</td>
<td>1 545</td>
<td>9</td>
<td>1 181</td>
<td>345</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>Portugal</td>
<td>1 320</td>
<td>102</td>
<td>756</td>
<td>401</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>Austria</td>
<td>1 290</td>
<td>24</td>
<td>683</td>
<td>581</td>
<td>2</td>
<td>12</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>1 233</td>
<td>24</td>
<td>843</td>
<td>355</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>1 231</td>
<td>17</td>
<td>852</td>
<td>357</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td>Sweden</td>
<td>1 016</td>
<td>13</td>
<td>673</td>
<td>320</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Finland</td>
<td>964</td>
<td>9</td>
<td>517</td>
<td>428</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Denmark</td>
<td>953</td>
<td>10</td>
<td>798</td>
<td>117</td>
<td>28</td>
<td>4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>875</td>
<td>52</td>
<td>651</td>
<td>163</td>
<td>9</td>
<td>-</td>
</tr>
<tr>
<td>Croatia</td>
<td>757</td>
<td>13</td>
<td>348</td>
<td>382</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>Lithuania</td>
<td>708</td>
<td>4</td>
<td>510</td>
<td>189</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>706</td>
<td>0</td>
<td>41</td>
<td>634</td>
<td>31</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>645</td>
<td>59</td>
<td>499</td>
<td>83</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Slovakia</td>
<td>536</td>
<td>12</td>
<td>385</td>
<td>139</td>
<td>0</td>
<td>-</td>
</tr>
<tr>
<td>Latvia</td>
<td>432</td>
<td>2</td>
<td>295</td>
<td>124</td>
<td>11</td>
<td>8</td>
</tr>
<tr>
<td>Estonia</td>
<td>285</td>
<td>2</td>
<td>165</td>
<td>106</td>
<td>12</td>
<td>-</td>
</tr>
<tr>
<td>Slovenia</td>
<td>261</td>
<td>7</td>
<td>133</td>
<td>119</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Cyprus</td>
<td>77</td>
<td>5</td>
<td>47</td>
<td>22</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>52</td>
<td>1</td>
<td>34</td>
<td>17</td>
<td>0</td>
<td>-</td>
</tr>
<tr>
<td>Malta</td>
<td>22</td>
<td>0</td>
<td>5</td>
<td>15</td>
<td>2</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: ECA based on Commission data.
Annex 6.2 — Follow-up of previous recommendations

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In most respects</td>
</tr>
<tr>
<td>2019</td>
<td>We recommend the following:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recommendation 1: The Commission should update its analysis of CAP fraud risks more frequently, perform an analysis of Member States’ fraud prevention measures, and disseminate best practices in the use of the Arachne tool to further encourage its use by paying agencies.</td>
<td></td>
</tr>
</tbody>
</table>

Source: ECA.
Chapter 7

Migration and border management
Security and defence
Contents

Introduction 7.1.-7.9.
Brief description 7.2.-7.8.
Audit scope and approach 7.9.

Regularity of transactions 7.10.-7.11.

Examination of elements of internal control systems 7.12.-7.14.
Review of audit authorities’ work in relation to their annual control reports and audits of expenditure 7.12.-7.14.

Annual activity reports and other governance arrangements 7.15.-7.16.

Conclusion and recommendations 7.17.-7.19.
Conclusion 7.17.
Recommendations 7.18.-7.19.

Annexes
Annex 7.1 – Follow-up of previous recommendations
**Introduction**

7.1. This chapter presents our findings for *multiannual financial framework (MFF)* headings 4 ‘Migration and border management’ and 5 ‘Security and defence’. We report on these headings in a common chapter, since they were mainly budgeted for and recorded under a single heading, MFF3 ‘Security and citizenship’, in the previous MFF period. *Figure 7.1* and *Figure 7.2* give an overview of the main activities and spending under these headings in 2021.
Figure 7.1 – Payments and audit population – Migration and border management

2021 payments breakdown by fund

- Asylum, Migration and Integration Fund (AMIF): 1.2 (48.2%)
- Decentralised agencies: 0.9 (35.6%)
- Internal Security Fund - Borders and Visa (ISF-BV): 0.4 (16.2%)

2021 audit population compared to payments

- Pre-financing payments (*): 2.2
- Interim and final payments: 0.3

- Annual decision to accept the accounts: 1.0
- Clearing of pre-financing (**): 1.3
- Interim and final payments: 0.3

(*) Pre-financing includes shared management payments for the 2014-2020 programming period that were not included in the accounts underlying the assurance packages which the Commission accepted in 2021.

(**) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

Source: ECA, based on data from the 2021 consolidated accounts of the European Union.
Figure 7.2 – Payments and audit population – Security and defence

2021 payments breakdown by fund

- European Defence Fund: 0.2 (29.2%)
- Decentralised agencies: 0.2 (28.7%)
- Internal Security Fund - Police (ISF-P): 0.2 (24.3%)
- Nuclear safety and decommissioning: 0.1 (17.8%)

2021 audit population compared to payments

- 2021 payments – total 0.7
  - Pre-financing payments (*): 0.6
  - Interim and final payments: 0.1

- 2021 audit population – total 0.6
  - Clearing of pre-financing (**): 0.4
  - Annual decision to accept the accounts: 0.1
  - Interim and final payments: 0.1

(*) Pre-financing includes shared management payments for the 2014-2020 programming period that were not included in the accounts underlying the assurance packages which the Commission accepted in 2021.

(**) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

Source: ECA, based on data from the 2021 consolidated accounts of the European Union.
Given the increasing importance of migration and border management in recent years, the European Union has established heading 4 of the 2021-2027 MFF specifically for these policy areas. The most significant spending area in 2021 concerns the completion of projects and schemes outstanding from the 2014-2020 MFF. Thus, as shown in Figure 7.1, most spending comes from the winding-up of the Asylum, Migration and Integration Fund (AMIF) for 2014-2020 and the completion of funding from the Internal Security Fund – Borders and Visa instrument (ISF-BV). The objective of the 2014-2020 AMIF was to contribute to the effective management of migration flows and bring about a common EU approach to asylum and immigration. The aim of the ISF-BV was to contribute to ensuring a high level of security in the EU while facilitating legitimate travel, through a uniform and high level of control of the external borders and the effective processing of Schengen visas.

These 2014-2020 funds have been replaced for 2021-2027 by, respectively, a new AMIF3 and the Instrument for Financial Support for Border Management and Visa Policy (BMVI) of the Integrated Border Management Fund (IBMF). AMIF’s objective for 2021-2027 is to contribute to the efficient management of migration flows and to the implementation, strengthening and development of the common policy on asylum and immigration. The BMVI’s objective is to support strong and effective integrated border management at the Union’s external borders, ensuring a high level of security and safeguarding the free movement of persons on EU territory.

Another significant spending area for heading 4 is the funding for three decentralised agencies (EUAA, Frontex, eu-LISA) that are active in the implementation of key EU priorities in the areas of migration and border management.

---

1 Regulation (EU) No 516/2014 establishing the Asylum, Migration and Integration Fund.
2 Regulation (EU) No 515/2014 establishing, as part of the Internal Security Fund, the instrument for financial support for external borders and visa.
3 Regulation (EU) 2021/1147 establishing the Asylum, Migration and Integration Fund.
4 Regulation (EU) 2021/1148 establishing, as part of the Integrated Border Management Fund, the Instrument for Financial Support for Border Management and Visa Policy.
5 We report separately on these agencies in our specific annual reports.
7.5. In the 2021-2027 MFF, heading 5 is devoted to security and defence. As shown in Figure 7.2, the ‘security’ component includes completion of funding from the Internal Security Fund – Police instrument for 2014-2020, funding for nuclear decommissioning (EU financial support for the decommissioning of nuclear installations in Bulgaria, Lithuania and Slovakia), and funding for three EU decentralised agencies in the area of security (EMCDDA, Europol, CEPOL). The ‘defence’ component includes the European Defence Fund, which supports collaborative defence projects at all stages of research and development.

7.6. The Internal Security Fund (ISF) is narrower in scope for 2021-2027 than it was previously (since the objectives of the 2014-2020 ISF-BV have been moved to a different instrument), and is now limited to the funding aims of the 2014-2020 ISF – Police instrument. These are to contribute to ensuring a high level of security in the EU, in particular by preventing and combating terrorism, radicalisation, serious and organised crime and cybercrime, by assisting and protecting victims of crime, and by preparing for, protecting against and effectively managing security-related incidents, risks and crises. However, the most significant spending area in 2021 concerns the completion of projects remaining from the 2014-2020 MFF.

7.7. The management of most AMIF and ISF funding for 2014-2020 is shared between the Member States (or Schengen associated countries) and the Commission’s DG for Migration and Home Affairs (DG HOME). Under this arrangement, Member States implement multiannual AMIF and ISF national programmes that have been approved by the Commission.

---

6 We report separately on these agencies in our specific annual reports.


8 Regulation (EU) 513/2014 establishing, as part of the Internal Security Fund, the instrument for financial support for police cooperation, preventing and combating crime, and crisis management.
7.8. In 2021, Member States again stepped up implementation of their national programmes. Despite this, significant amounts remain undisbursed, and the fact that funding for 2014-2020 has to be spent by June 2024 may increase the pressure on national authorities. Figure 7.3 summarises the expenditure that Member States have reported to the Commission for reimbursement since the beginning of the 2014-2020 programming period.

**Figure 7.3 – Expenditure on AMIF and ISF national programmes up again, but much of the budget still unused**

(*) AMIF/ISF expenditure at Member State level is declared to and approved by the Commission the year after it is incurred. Thus, the Commission’s accounts for 2021 show Member State spending from 2020.

*Source:* ECA, based on Commission data (national programmes and clearance decisions until the end of 2021).

---

9 Regulation (EU) 2022/585 laying down general provisions on the Asylum, Migration and Integration Fund and on the instrument for financial support for police cooperation, preventing and combating crime, and crisis management.
Audit scope and approach

7.9. Applying the audit approach and methods set out in Annex 1.1, we examined the following for these MFF headings in 2021:

(a) a sample of 28 transactions which, while contributing to the overall statement of assurance, is not representative of the spending under these MFF headings. We therefore cannot provide an estimate of the error rate for these headings. The sample consisted of 14 transactions under shared management with Member States\(^{10}\) (two transactions per Member State), six under the Commission’s direct management (for heading 4) and five under its indirect management (two for heading 4, three for heading 5), as well as three clearings of advances to agencies (two for heading 4, one for heading 5).

(b) the regularity information given in the annual activity report (AAR) of DG HOME and then included in the Commission’s annual management and performance report (AMPR).

(c) selected systems, which concerned:

(i) the annual control reports received from three audit authorities\(^{11}\) and submitted with the 2020 annual accounts for AMIF and the ISF; we assessed whether those reports were compliant with the relevant regulation\(^{12}\);

(ii) the work of the same audit authorities; we assessed whether their audits of expenditure and their procedures for providing reliable audit opinions were appropriate.

---

\(^{10}\) Spain, France, Italy, Poland and Sweden for heading 4; Bulgaria and Lithuania for heading 5.

\(^{11}\) Bulgaria, Malta and Sweden.

\(^{12}\) Commission Delegated Regulation (EU) 2018/1291 on the designation and management and control responsibilities of responsible authorities, and the status and obligations of audit authorities.
Regularity of transactions

7.10. Of the 28 transactions we examined, nine (32 %) were affected by errors. We have quantified six errors which had an impact on the amounts charged to the EU budget. These errors related to the absence of supporting documents, ineligible expenditure and public procurement. Box 7.1 shows examples of errors we have quantified.

Box 7.1

Acquisition of ineligible vehicle types

We audited an ISF-Police project under shared management with Bulgaria. The project was implemented by a ministerial department and consisted of the purchase of 18 new off-road vehicles.

We randomly selected a sample of ten vehicles purchased during the project for detailed checks. We found that only five of these vehicles met the definition of off-road vehicles in Directive 2007/46/EC. We therefore considered 50 % of the project costs to be ineligible expenditure. Furthermore, the register of vehicle use was not sufficiently detailed to demonstrate that the vehicles purchased were being used solely in connection with the project.

Ineligibility of declared accommodation costs

One AMIF emergency assistance project that we audited was implemented by a ministerial department in Ireland. It consisted of the provision of emergency accommodation (including meals) to asylum-seekers. Because their accommodation portfolio had insufficient capacity to meet demand, the Irish authorities used a call for expressions of interest to rent rooms at hotels and guesthouses. We checked a sample of ten invoices included in the cost claim.

We audited the procurement procedure that led to the signature of contracts with hotels and guesthouses. Since the Irish authorities failed to provide certain key procurement documents and information, we were unable to verify whether the procurement had been properly organised. We also found that tenderers had been treated unequally (e.g. one bid was rejected because the hotel in question had too few available rooms, but bids from other hotels with the same or even less capacity were accepted). As a consequence, we have no evidence that these contracts were awarded on the basis of the applicable public procurement legislation. We thus considered 100 % of the declared expenditure ineligible for EU funding.
Furthermore, some of the contracts concluded with hotels were not valid because they were not signed by both parties or did not cover the period of the invoices we checked. In addition, some of the invoiced amounts lacked a contractual basis. This also affects the eligibility of expenditure.

The Irish authorities did not properly monitor and document actual use of the emergency accommodation. Nor did they provide satisfactory evidence that the people lodged in hotels really were asylum-seekers.

The Irish authorities submitted an audit certificate to accompany the cost claim, but none of the errors described above had been reported by the external auditors. Nor did DG HOME find these errors when making checks prior to payment.

7.11. We also found six cases of non-compliance with legal and financial provisions (but with no impact on the EU budget). These related to, for example, the submission of incomplete documentation in support of cost claims and a partially non-transparent methodology for calculating standard unit costs as part of a simplified cost option.
Examination of elements of internal control systems

Review of audit authorities’ work in relation to their annual control reports and audits of expenditure

7.12. We reviewed the work done by three audit authorities when auditing their Member States’ AMIF/ISF annual accounts (Malta and Sweden for AMIF; Bulgaria for the ISF) and providing the Commission with an annual control report (ACR). Our purpose was to assess whether these authorities had:

(a) covered all types of payment made by the bodies responsible for implementing the funds;

(b) used an appropriate sampling methodology;

(c) sampled sufficient transactions to allow conclusions to be drawn for the whole population;

(d) correctly calculated the error rate\(^{13}\); and

(e) put in place adequate procedures for providing reliable audit opinions and reports\(^{14}\).

7.13. The audit authorities had developed and implemented detailed procedures of sufficient quality to report on their work in the ACRs. However, we identified shortcomings in their reporting. The Commission had already identified all of these issues in its assessment of ACRs for the 2020 financial year. We present our findings in Box 7.2.

---

\(^{13}\) As required by Commission Delegated Regulation (EU) 2018/1291.

\(^{14}\) In line with key requirement 14 for management and control systems in the Annex to Commission Implementing Regulation (EU) 2017/646 on the implementation of the annual clearance of accounts procedure and the implementation of the conformity clearance.
Box 7.2

Shortcomings in annual control reports

<table>
<thead>
<tr>
<th>Shortcomings</th>
<th>Member State</th>
<th>Potential impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>No random sampling used for audits of expenditure, which is not compliant</td>
<td>Malta</td>
<td>Limited assurance from the audit authority’s work</td>
</tr>
<tr>
<td>The authority responsible for implementing funding submitted the draft</td>
<td>Malta</td>
<td>Reported data was not reliable</td>
</tr>
<tr>
<td>accounts to the audit authority before completing its own controls.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Therefore, the audit population from which the audit authority drew its</td>
<td></td>
<td></td>
</tr>
<tr>
<td>audit sample was not accurate.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No explanation given for the differences between the draft and final</td>
<td>Sweden</td>
<td></td>
</tr>
<tr>
<td>accounts.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inaccurate presentation of the residual error rate, and incorrect audit</td>
<td>Malta</td>
<td></td>
</tr>
<tr>
<td>opinion on the accounts.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incomplete reporting on audits of expenditure relating to negative payments</td>
<td>Bulgaria</td>
<td></td>
</tr>
<tr>
<td>or payments to clear advances declared in a previous year’s accounts.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**7.14.** We selected 15 audit files from the same three audit authorities. We used these files to check that the audit procedures established by the audit authorities were appropriate and covered all the eligibility criteria set in the AMIF/ISF regulations. Overall, we found that the audit authorities had detailed audit programmes and used checklists to support their conclusions. However, we also detected the shortcomings outlined in Box 7.3.

---

15 See key requirement 12 in the annex to Commission Implementing Regulation (EU) 2017/646.
### Box 7.3

**Shortcomings in the work of audit authorities**

<table>
<thead>
<tr>
<th>Shortcomings</th>
<th>Member State</th>
<th>Potential impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project selection process not properly checked.</td>
<td>Sweden</td>
<td>Failure to detect ineligible expenditure</td>
</tr>
<tr>
<td>Procurement procedures not properly checked.</td>
<td>Bulgaria</td>
<td>Audit conclusions not reliable</td>
</tr>
<tr>
<td>Inadequate testing of the eligibility of expenditure.</td>
<td>Bulgaria</td>
<td>Limited assurance from the audit authority’s work</td>
</tr>
<tr>
<td>Inadequate testing of the eligibility of expenditure.</td>
<td>Sweden</td>
<td></td>
</tr>
<tr>
<td>Insufficient <em>audit trail</em> or poor documentation of audit work and results.</td>
<td>Bulgaria</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sweden</td>
<td></td>
</tr>
</tbody>
</table>
Annual activity reports and other governance arrangements

7.15. For the 2021 financial year, we reviewed the AAR of DG HOME. Our analysis focused on whether DG HOME had presented the regularity information in its AAR in accordance with the Commission’s instructions, and whether this information was consistent with the knowledge we had obtained during our audits. We found no information that might contradict our findings.

7.16. We reviewed DG HOME’s estimates for risks at payment and at closure. We found that they were calculated in accordance with internal methodology and correctly reported in the AMPR. Of the total expenditure in 2021 (€2 511 million), DG HOME estimated the total amount at risk at the time of payment to be €48 million (1.91 %), and it estimated the value of corrections resulting from its checks in future years at €16 million.

The Director-General of DG HOME declared that she had reasonable assurance that the resources assigned to the activities described in the AAR had been used for their intended purpose and in accordance with the principles of sound management, but with some reservations. As our checks on 25 transactions concern only a small proportion of the transactions under DG HOME’s responsibility, we are unable to verify this statement against the results of our audit work.
Conclusion and recommendations

Conclusion

7.17. Our examination of transactions and systems highlighted two areas where there is scope for improvement (see paragraphs 7.10 and 7.11). We did not audit sufficient transactions to estimate the level of error for these MFF headings (see paragraph 7.9). The results of transaction testing contribute to our statement of assurance.

Recommendations

7.18. Annex 7.1 shows the findings of our follow-up review of the three recommendations we made in our 2019 annual report and that were targeted for implementation during 2021. We found that the Commission had implemented these three recommendations in full:

(a) We consider recommendation 1, that the Commission issue guidance to the audit authorities for AMIF and the ISF on calculating audit coverage if they use sub-sampling, to have been implemented. We base this on the fact that, in July 2021, DG HOME issued a guidance note on sub-sampling.

(b) We consider recommendation 2, that the Commission remind the audit authorities for AMIF and the ISF to follow its instructions on sampling and calculating the error rate, to have been implemented. We base this on the fact that the Commission has provided appropriate and customised sampling guidance and feedback via the letters it sent to the audit authorities in the context of the annual clearance of accounts.

(c) We consider recommendation 3, that the Commission issue guidance to the audit authorities for AMIF and the ISF on documenting their audit procedures, their results and the audit evidence collected, to have been implemented. We base this on the fact that, in March 2021, the Commission sent the audit authorities a brochure entitled “Reflection paper on audit documentation – Good practices from and for auditors”.
Based on this review and our findings and conclusions for 2021, we recommend that the Commission:

**Recommendation 7.1 – Audit trail and procurement**

Provide further guidance to the *beneficiaries* of Union action and emergency assistance, and the Member State authorities responsible for implementing DG HOME funding, on adhering to:

(a) the rules for collecting appropriate supporting documentation that can be produced in the event of checks or audits;

(b) the obligation to comply with the national rules on public procurement when purchasing goods or services.

*Target implementation date: End of 2023*

**Recommendation 7.2 – Eligibility of project costs for actions directly managed by DG HOME**

Carry out better targeted *ex ante* checks on the eligibility of expenditure, especially in the case of emergency assistance, with a specific focus on the potential risks related to:

(a) the type of expenditure (e.g. procurement) and;

(b) the type of beneficiary (e.g. beneficiaries with little or no experience of EU funding).

In doing this, the Commission should take into consideration the fact that using audit certificates to support beneficiaries’ payment claims has limitations.

*Target implementation date: End of 2023*
## Annexes

### Annex 7.1 – Follow-up of previous recommendations

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2019</td>
<td>We recommend that the Commission:</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Recommendation 1:</strong> Issue guidance to the Member States’ audit authorities for AMIF and the ISF on how to calculate audit coverage if they apply sub-sampling. Advice should be given for ensuring that sampling is sufficient and appropriate to provide a reasonable basis for the auditor to draw conclusions about the entire audit population.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Timeframe:</strong> during 2021</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>ECA recommendation</td>
<td>ECA’s analysis of the progress made</td>
</tr>
<tr>
<td>------</td>
<td>--------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In most respects</td>
</tr>
<tr>
<td>Recommendation 2: Reiterate to the Member States’ audit authorities for AMIF and the ISF that they must follow the Commission’s instructions on sampling and calculating the error rate. Specifically, sampling should be random, each sampling unit in the population should have a chance of selection and, where applicable, all errors should be extrapolated to the relevant population.</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Timeframe: during 2021</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recommendation 3: Issue guidance to the Member States’ audit authorities for AMIF and the ISF to document the nature, timing and extent of their audit procedures, their results, and the audit evidence collected, in a sufficient and appropriate way.</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Timeframe: during 2021</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: ECA.
Chapter 8

Neighbourhood and the world
Contents

Introduction 8.1.-8.7.
Brief description 8.2.-8.6.
Audit scope and approach 8.7.


Annual activity reports and other governance arrangements 8.15.-8.26.
DG ECHO AAR 8.15.-8.19.
DG NEAR’s 2021 RER study 8.20.-8.25.

Conclusion and recommendations 8.27.-8.33.
Conclusion 8.27.
Recommendations 8.28.-8.33.

Annexes
Annex 8.1 – Payments per delegation for DG NEAR and DG INTPA
Annex 8.2 – Follow-up of previous recommendations for ‘Neighbourhood and the world’
**Introduction**

8.1. This chapter presents our findings for *multiannual financial framework (MFF)* heading 6 ‘Neighbourhood and the world’. *Figure 8.1* gives an overview of the main activities and spending under this heading in 2021.

**Figure 8.1 – Payments and audit population**

**Neighbourhood and the world**

€10.9 billion (6.0 % of EU budget spending)

### 2021 payments breakdown by fund

- Neighbourhood, Development and International Cooperation – Global Europe (NDICI-Global Europe): 5.8 (53.0%)
- Humanitarian aid (HUMA): 2.4 (22.4%)
- Pre-accession assistance (IPA): 2.2 (20.0%)
- Other actions and programmes: 0.5 (4.6%)

### 2021 audit population compared to payments

#### 2021 payments – total €10.9 billion

- Interim / final payments: 2.8
- Pre-financing payments (*): 8.1

#### 2021 audit population – total €10.0 billion

- Interim / final payments: 2.8
- Clearing of pre-financing (incl. trust fund disbursements) (*): 7.2

(*) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

*Source: ECA, based on data from the 2021 consolidated accounts of the European Union.*
Brief description

8.2. The spending area comprises several funding instruments, most notably the new Neighbourhood, Development and International Cooperation Instrument - Global Europe (‘NDICI-Global Europe’)\(^1\) and the Instrument for Pre-accession Assistance. It also covers the humanitarian aid budget.

8.3. The general objective of NDICI-Global Europe is to uphold and promote EU values, principles and fundamental interests worldwide, and help promote multilateralism and stronger partnerships with non-EU countries. It reflects two major changes, compared to the 2014-2020 MFF, in the way the EU finances external action (foreign policy):

(a) cooperation with African, Caribbean and Pacific partner countries, previously financed by the European Development Funds, has now been brought under the EU’s general budget;

(b) such cooperation is now funded under the same instrument as the EU’s neighbourhood policy, while preserving the specific features of both types of support.

8.4. The general objective of the Instrument for Pre-accession Assistance is to support beneficiary countries in adopting and implementing the reforms required to align with EU values with a view to membership, thereby contributing to their stability, security and prosperity.

8.5. The main directorates-general and services involved in implementing EU external action are the Directorate-General for Neighbourhood Policy and Enlargement Negotiations (DG NEAR), the Directorate-General for International Partnerships (DG INTPA), the Directorate-General for European Civil Protection and Humanitarian Aid Operations (DG ECHO) and the Service for Foreign Policy Instruments (FPI).

In 2021, payments for ‘Neighbourhood and the world’ amounted to €10.9 billion (final payments, including assigned revenue) and were disbursed using several instruments (see *Figure 8.1*) and delivery methods such as works/supply/service contracts, grants, special loans, loan guarantees and financial assistance, *budget support* and other targeted forms of budgetary aid in more than 150 countries (see *Annex 8.1*).

**Audit scope and approach**

Applying the audit approach and methods set out in *Annex 1.1*, we examined the following for this MFF heading in 2021:

(a) a sample of 67 transactions which, while contributing to our overall statement of assurance, is not representative of the spending under this MFF heading. We are therefore unable to provide an estimate of the error rate for this heading. We sampled 37 DG NEAR, 14 DG INTPA, 12 DG ECHO and four FPI transactions.

(b) the regularity information given in the annual activity report (AAR) of DG ECHO and then included in the European Commission’s *annual management and performance report (AMPR)*.
Regularity of transactions

8.8. Of the 67 transactions we examined, 32 (48%) were affected by errors. Despite the limited sample size, our audit results confirm that the risk of error in this MFF heading is high. We have quantified 24 errors which had an impact on the amounts charged to the EU budget. The most common categories of error for ‘Neighbourhood and the world’ were expenditure not incurred, ineligible costs, absence of supporting documents and public procurement errors. Box 8.1 presents examples of errors we quantified.

Box 8.1

Part of expenditure not incurred

DG NEAR

We audited expenditure claimed under a contribution agreement by an international organisation dedicated to gender equality and empowering women for an action aimed at challenging gender stereotypes in the Eastern Partnership countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine). According to the contribution agreement, the action’s total estimated cost is €7.9 million, with an EU contribution of up to €7 million.

For the first 12 months of the three-year implementation period, the beneficiary reported €2.2 million of incurred expenditure, which the Commission accepted. We examined the supporting documents and found that the eligible expenditure amounted to only €1.2 million. The international organisation had wrongly reported €977,434 as incurred expenditure. Although it had committed this amount, it had not yet actually spent it. The Commission had therefore incorrectly cleared 44% of the audited amount.

Serious failure to respect procurement rules

DG INTPA

We audited an invoice for €823,066 issued by the contractor under a service contract worth €3.8 million concluded in 2017 for a support facility for recovery and reconstruction. The purpose of this contract was to provide the government with demand-driven technical expertise for reconstruction following a natural disaster in the country concerned.

The Commission awarded the contract via a competitive negotiated procedure, having invited eight companies to submit tenders. It had listed seven of these companies as potential service providers under an earlier framework contract. The
eighth company (the successful tenderer) was invited to submit its tender after approaching the EU delegation in that country to express its interest in the project shortly before the procurement procedure started. The capacity of the companies invited to submit tenders had not been assessed in advance for this procedure.

The evaluation committee invited the three technically compliant tenderers for interviews, even though the tender documentation clearly specified that no such interviews were planned. The interviews resulted in the successful tenderer’s technical score being increased from 82 to 86 points, while its competitors’ scores remained unchanged. Without this increase, one of those competitors would have achieved a higher overall score and been awarded the contract.

The contract was thus awarded to a company whose capacity had not been assessed beforehand and whose technical score had been changed following interviews that the procedure was not meant to include. We therefore consider that the outcome of the procurement procedure was incorrect.

8.9. We also found 12 cases of non-compliance with legal and financial provisions. These did not have an impact on the EU budget, but failure to follow the rules can undermine sound financial management and potentially render costs ineligible. The cases of non-compliance related to the selection of projects and application of procurement rules, the submission of documentation to support cost claims, and the linking of costs incurred to the appropriate budget lines.

8.10. We identified two spending areas where transactions are less prone to errors due to specific payment conditions. These areas are (i) budget support (see paragraph 8.11) and (ii) projects implemented by international organisations and subject to the ‘notional approach’ (see paragraph 8.12). In 2021, we audited three budget support transactions and 22 projects managed by international organisations, including five ‘notional approach’ transactions.

8.11. Budget support is a contribution to a state’s general budget or its budget for a specific policy or objective. Budget support payments financed by the EU general budget in 2021 amounted to €0.8 billion. We examined whether the Commission had complied with the conditions governing budget support payments to partner countries and had verified that these countries met the eligibility conditions (such as satisfactory improvement in public-sector financial management). Our regularity audit cannot cover what happens after the Commission pays aid to the recipient country, since
these funds then merge with that country’s own budget resources\(^2\). Box 8.2 illustrates an example of a finding relating to a budget support operation where it was not possible to establish the exact ineligible amount.

**Box 8.2**

**Unclear conditions for bank transfers of budget support instalments**

**DG INTPA**

We audited a budget support instalment of €2.9 million relating to the reform of the beneficiary country’s national policy to help certain groups of people reintegrate into society and find jobs.

The EU’s financing agreement with that beneficiary country’s government provides that the conversion of funds from euros to local currency must take place on the date they are credited to the relevant central bank account, without specifying what ‘relevant account’ means.

At the government’s request, the Commission transferred the funds in euros to a commercial bank account in Europe. A bank statement showed only an internal transfer in the local currency from one central bank account to another more than ten days later. The exchange rate used to convert euros into local currency was the one applicable on the date the funds were credited to the account in Europe. In these 10 days, the local currency had devalued.

The Commission accepted the operation, despite the delay in crediting the funds to the beneficiary country’s central bank.

Due to the lack of clarity as to which account was the ‘relevant’ one and lack of evidence of when the funds were actually credited to that account, we were unable to establish the error’s exact financial impact.

**8.12.** Under the ‘notional approach’, when contributions from the Commission to multi-donor projects are pooled with those from other donors and not earmarked for specific, identifiable items of expenditure, the Commission assumes that expenditure is compliant with EU eligibility rules provided that the total pooled amount includes sufficient eligible expenditure to cover the EU’s contribution. We took this approach into account in our substantive testing. In 2021, payments to international

---

\(^2\) A number of our special reports consider the efficiency and effectiveness of budget support, the latest ones being special report 09/2019: “EU support to Morocco – Limited results so far” and special report 25/2019: “Data quality in budget support: weaknesses in some indicators and in the verification of the payment for variable tranches”. 

organisations from the EU general budget amounted to €3.6 billion. We cannot state the proportion of this amount to which the ‘notional approach’ applies, since the Commission does not monitor it separately. We detected one non-quantifiable error in this area.

8.13. When examining the regularity of transactions, we also noted examples of effective controls. We present one such example in Box 8.3.

**Box 8.3**

**Ineligible expenditure identified in verification report**

**DG NEAR**

The Commission, through a grant contract, financed a measure with a budget of €400 million to give migrant children access to the national education system in their host country.

Our audit of expenditure claimed under this grant contract found that the Commission had correctly rejected an amount of €306 873 following its expenditure verification. The ineligible expenditure concerned, in particular, the use of an incorrect procurement procedure to purchase vehicles.

8.14. As in previous years, some international organisations provided only limited access to documents (e.g. in read-only format), meaning we could not make copies of them. These issues hindered the planning and execution of our audit and led to delays in the audit team receiving the requested documentation and carrying out its work. We made related recommendations in our 2018 and 2020 annual reports. Although the Commission has stepped up its communication with the international organisations, we continue to have difficulties obtaining the requested documentation.
Annual activity reports and other governance arrangements

DG ECHO AAR

**8.15.** For the 2021 financial year, we reviewed the AAR of the Directorate-General for Civil Protection and Humanitarian Aid Operations (DG ECHO). Our analysis focused on whether DG ECHO had presented the regularity information in its AAR in accordance with the Commission’s instructions and had been consistent in its application of the methodology for estimating future corrections and recoveries.

**8.16.** The total expenditure accepted in 2021 (€3 092 million) was the highest ever for DG ECHO. Of this amount, DG ECHO estimated the total amount at risk at the time of payment to be €15.8 million (0.51 %), and it estimated the value of corrections resulting from its checks in future years at €11.8 million (74.7 % of the total amount at risk; this proportion is known as the ‘corrective capacity’).

**8.17.** This is the highest value of estimated future corrections ever reported by DG ECHO, both in absolute terms and in terms of corrective capacity. Its corrective capacity has increased every year since 2016, when it was 33.5 %. DG ECHO’s corrective capacity for 2021 is also high, compared to other DGs in the area of external relations (for example, 14.4 % for DG NEAR, 17.1 % for DG INTPA and 37.3 % for FPI).

**8.18.** Based on the low estimated residual error rate, the Director-General of DG ECHO declared the DG’s financial exposure to be below the materiality threshold of 2 %. As only a small proportion of our checks concern transactions under DG ECHO’s responsibility, we are unable to verify this statement based on the results of our work.

**8.19.** The COVID-19 pandemic and political crises have put the delivery of humanitarian aid at risk, as they have restricted or prevented access to people affected by humanitarian crisis. This risk concerns not only humanitarian needs assessments, but also the delivery of aid itself as well as related controls. DG ECHO considers that humanitarian aid procedures and policies include measures to mitigate such risks.
DG NEAR’s 2021 RER study

8.20. In 2021, DG NEAR had its seventh residual error rate (RER) study carried out by an external contractor on its behalf. The purpose of the study is to estimate the rate of those errors not detected by all DG NEAR management checks to prevent, detect and correct such errors across its entire area of responsibility, in order to conclude on the effectiveness of those checks. It is an important element for the Director-General’s declaration of assurance, and feeds into the regularity information on external action disclosed in the AMPR.

8.21. DG NEAR presented the results of the 2021 RER study in its AAR. The estimated overall RER for the DG (referred to as the ‘global (DG derived) error rate’ in the AAR) was 1.05%, below the 2% materiality threshold set by the Commission. This rate consists of the main rate and the ‘indirect management by beneficiary countries’ (IMBC) rate. The corresponding RER sample consisted of 266 transactions under contracts closed during the reference period (September 2020 to August 2021). The 2020 RER was 1.36%. DG NEAR also calculated an estimated residual error rate for grants under direct management (the ‘grant residual error rate’). However, this rate is not included in the calculation of the DG’s overall RER.

8.22. The RER study does not constitute an assurance engagement or an audit. It is based on the RER methodology provided by DG NEAR. Our previous annual reports, have already described limitations in the studies that may contribute to the RER’s underestimation.

8.23. The RER rules exclude certain categories of contracts, including ‘old contracts’ and DG NEAR thematic grant contracts. Old contracts are those under which there has been no operational or control activity in the past five years, or which have been dormant for more than eight years. The population for the 2021 RER exercise excluded old contracts closed during the reference period with a total value of €389 million. Such contracts could not be sampled for review in previous RER exercises and will not be subject to any review in the future.

8.24. The RER sampling population for the ‘global (DG derived) error rate’ also excluded DG NEAR thematic grant contracts amounting to €50 million. RER rules state that these contracts are the responsibility of DG INTPA, although they are not covered by that DG’s RER study.

---

8.25. At €439 million, the above two types of excluded contracts together account for around 20% of DG NEAR’s portfolio of closed contracts of €2.27 billion. This is a substantial share to permanently exclude from any RER review, especially considering that the final RER sampling population for the ‘global (DG derived) error rate’ is worth about €1.7 billion, and might result in errors remaining undetected. The exclusion of these contracts represents a limitation not disclosed by DG’NEAR in its 2021 AAR.

DG INTPA’s AAR

8.26. The work done on DG INTPA’s 2021 AAR is presented in detail in our annual report on the 8th, 9th, 10th and 11th European Development Funds. In 2019, the Commission closed the remaining outstanding transactions for 8th EDF projects. All balances and decommitments have been transferred to the 9th EDF. In 2021, it announced the financial and operational closure of the 8th EDF. All 8th EDF activities have been completed, all checks and controls have been performed, and all contracts and financial decisions are closed in the 2021 EDF accounts.
Conclusion and recommendations

Conclusion

8.27. Our examination of transactions and systems highlighted three areas with scope for improvement. While we did not audit sufficient transactions to estimate the level of error for this MFF heading (see paragraph 8.7), our audit results confirm that it is a high-risk area. The results of transaction testing contribute to our statement of assurance.

Recommendations

8.28. Annex 8.2 shows the findings of our follow-up review of the three recommendations we made in our 2018 annual report. The Commission had implemented two recommendations in full, while one had been implemented in some respects.

8.29. We consider recommendation 2, that the Commission adapt DG NEAR’s RER methodology to limit full-reliance decisions and monitor its implementation closely, to have been implemented. We base this on the fact that the Commission updated its RER instruction manual for 2020.

8.30. We also consider recommendation 3, that the Commission revise DG ECHO’s calculation of the 2019 corrective capacity by excluding recoveries of unspent pre-financing, to have been implemented. We base this on the fact that the Commission updated the applicable guidelines and issued additional quality control instructions between 2018 and 2020.

8.31. We also reviewed recommendations from the 2019 and 2020 annual reports that required immediate action or were targeted for implementation during 2021.

8.32. We consider recommendation 2 from our 2020 annual report, that DG ECHO establish a procedure to ensure that partner organisations base their allocation of shared costs on expenditure actually incurred, to have been implemented. We base this on the fact that DG ECHO conducted an ex ante assessment that non-governmental organisations had to pass before being certified as Commission humanitarian partners for the 2021-2027 period. The assessment includes checks to ensure that partners’ cost allocation systems allow only eligible costs actually incurred.
to be charged to their projects. In addition, DG ECHO has published guidance on the eligibility of costs and issued a decision allowing the use of unit costs for staff and field offices.

8.33. Based on this review and our findings and conclusions for 2021, we recommend that the Commission (see Box 8.1, Box 8.2 and paragraph 8.25).

**Recommendation 8.1 – Deduct costs not incurred before payment or clearing**

Take appropriate measures aimed at ensuring that any commitments or advance payments claimed as incurred costs by beneficiaries in their financial reports are deducted before carrying out payments or clearings.

**Target implementation date: End of 2023**

**Recommendation 8.2 – Strengthen controls when drafting financing agreements for budget support operations**

Strengthen controls when drafting financing agreements for budget support operations in order to set clear conditions in financing agreements regarding the transfer of funds to the treasury account in the beneficiary country’s central bank and the applicable exchange rate; these should be consistent with the budget support guidelines.

**Target implementation date: End of 2023**

**Recommendation 8.3 – Disclose contracts excluded from RER population**

Disclose the type and value of contracts excluded from the population of the RER study in the 2022 annual activity report and future annual activity reports.

**Target implementation date: in the 2022 annual activity report**
Annexes

Annex 8.1 – Payments per delegation for DG NEAR and DG INTPA

Top 5 DG NEAR (million euros)
1. Turkey 127
2. Moldova 109
3. Morocco 106
4. Egypt 88
5. Jordan 70

Top 5 DG INTPA (million euros)
1. Bangladesh 140
2. Iraq 103
3. Pakistan 89
4. Nepal 85
5. Afghanistan 77

Source: Created with “Tableau” by ECA, map background ©Mapbox and ©OpenStreetMap licensed under the Creative Commons Attribution-Share Alike 2.0 licence (CC BY-SA) and modified by ECA, based on data from the 2021 consolidated annual accounts of the European Union.
# Annex 8.2 – Follow-up of previous recommendations for ‘Neighbourhood and the world’

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
<th>Fully implemented</th>
<th>Implemented</th>
<th>Not Implemented</th>
<th>Not applicable</th>
<th>Insufficient evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>In most respects</td>
<td>In some respects</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>We recommend that the Commission:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recommendation 1:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>By 2020, take steps to reinforce the obligation on international organisations to forward the ECA,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>at its request, any document or information necessary to carry out its task as foreseen in the</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TFEU.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>We recommend that DG NEAR:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recommendation 2:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>By 2020, take steps to adapt DG NEAR’s RER methodology to limit full-reliance decisions, and that</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>it monitor its implementation closely.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4 The Commission intensified communication with international organisations regarding our access to documents. Some organisations, such as the World Bank Group (WBG), improved their cooperation with us, but others did not. Some United Nations (UN) organisations, such as the United Nations Children’s Fund (UNICEF) and the United Nations Population Fund (UNFPA), continue to provide read-only access to supporting documentation or do not provide access to all supporting documentation requested.
### 2019

We recommend that DG NEAR, DG DEVCO, DG ECHO, DG CLIMA and FPI:

Recommendation 3:
Strengthen checks by identifying and preventing recurrent errors (e.g. lack of time-recording systems and charging ineligible VAT to EU-funded projects).

Timeframe: by the end of 2021

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA's analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td>We recommend that DG ECHO:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recommendation 3:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revise the DG ECHO’s calculation of the 2019 corrective capacity by excluding recoveries of unspent pre-financing.</td>
<td></td>
</tr>
</tbody>
</table>

---

5 All DGs implemented the recommendation in full, with the exception of FPI. FPI launched an audit on the matter, and the report will be available by the end of 2022.
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA's analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 2020 | We recommend that the Commission:  
Recommendation 1:  
Take steps so that international organisations provide the ECA with complete, unlimited and timely access to documents necessary to carry out our task in accordance with the TFEU, and not just in read-only format.  
Timeframe: by the end of 2021 | | | X<sup>6</sup> | | | |
|      | We recommend that DG ECHO:  
Recommendation 2:  
Establish a procedure to ensure that partner organisations base their allocation of shared costs on expenditure actually incurred.  
Timeframe: by the end of 2021 | | | | X | | |

Source: ECA.

<sup>6</sup> See recommendation 1 from 2018.
Chapter 9

European public administration
Contents


Brief description 9.3.

Audit scope and approach 9.4.-9.5.

Observations on the sample of transactions 9.7.-9.11.
European Commission 9.10.
European External Action Service 9.11.
Observations on supervisory and control systems 9.12.

Annual activity reports and other governance arrangements 9.13.


Conclusion and recommendations 9.18.-9.20.
Conclusion 9.18.

Annexes
Annex 9.1 – Follow-up of previous recommendations for ‘European public administration’
Introduction

9.1. This chapter presents our findings for MFF heading 7, ‘European public administration’. Figure 9.1 gives an overview of the spending of the EU institutions and bodies under this heading in 2021.

Figure 9.1 – Payments and audit population

A) 2021 payments breakdown by institution

European Commission: 6.3 (58.5 %)
European Parliament: 2.1 (19.4 %)
European External Action Service: 1.0 (8.9 %)
Council of the European Union: 0.6 (5.3 %)
Court of Justice of the European Union: 0.4 (4.1 %)
European Court of Auditors: 0.1 (1.4 %)
European Economic and Social Committee: 0.1 (1.2 %)
Others: 0.1 (1.2 %)

B) 2021 audit population compared to payments (*)

2021 payments – total 10.7
Interim and final payments: 10.7

2021 audit population – total 10.7
Interim and final payments: 10.7

(*) Clearings and prefinancings in this MFF both amounted to €0.01 billion in 2021. We dealt with them in line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

Source: ECA, based on data from the 2021 consolidated accounts of the European Union.
9.2. We report separately on the EU agencies, other entities and on the European Schools\textsuperscript{1}. Our mandate does not cover the financial audit of the European Central Bank.

\textsuperscript{1} Our specific annual reports on agencies, other entities and European Schools are published on our website.
Brief description

9.3. Administrative expenditure comprises expenditure on human resources and pensions, which accounted in 2021 for about 68% of the total, and on buildings, equipment, energy, communications and information technology. Our work over many years indicates that overall this spending is low-risk.
Audit scope and approach

9.4. Applying the audit approach and methods set out in Annex 1.1, we examined the following for this MFF heading:

(a) a statistically representative sample of 60 transactions covering the full range of spending under this MFF heading. We took transactions from each EU institution and body. Our objective was to estimate the level of error for this MFF heading and to contribute to the statement of assurance.

(b) the supervisory and control systems of the European External Action Service (EEAS).

(c) the regularity information given in the annual activity reports of all the institutions and bodies, including those of the European Commission’s directorates-general and offices primarily responsible for administrative expenditure², and then included in the Commission’s Annual Management and Performance Report (AMPR).

(d) procedures for public procurement and recruiting local staff at the EEAS Delegations as an in-depth follow-up of weaknesses reported in our 2015 annual report.

9.5. Our own expenditure is audited by an external firm³. The results of its audit of our financial statements for the year ending 31 December 2021 are covered by paragraph 9.7.

² DG Human Resources and Security, Office for the Administration and Payment of Individual Entitlements, Offices for Infrastructure and Logistics in Brussels and Luxembourg, and DG Informatics.

³ ACG Auditing & Consulting Group S.r.l.
Regularity of transactions

9.6. *Figure 9.2* provides an overview of the results of transaction testing. Of the 60 transactions examined, 15 (25 %) contained errors. Based on the five errors we have quantified, we estimate the level of error to be below the *materiality threshold*.

**Figure 9.2 – Results of transaction testing for ‘European public administration’**

**Estimated impact of quantifiable errors**

<table>
<thead>
<tr>
<th>Materiality 2.0 %</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0 %</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Free from material error**

**Sample size**

<table>
<thead>
<tr>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>48 transactions</td>
<td>60 transactions</td>
</tr>
</tbody>
</table>

Source: ECA.

**Observations on the sample of transactions**

9.7. The issues discussed in paragraphs 9.8-9.11 concern the European Parliament, the European Commission and the European External Action Service. We did not identify any specific issues concerning the Council of the European Union, the Court of Justice of the European Union, the European Economic and Social Committee, the European Committee of the Regions, the European Ombudsman or the European Data Protection Supervisor. Our external auditor did not report any specific issue based on its work.

**European Parliament**

9.8. We detected two *quantifiable errors* in payments made by the European Parliament. One concerned a minor overpayment for IT services caused by the incorrect application of contract terms. The other was related to a payment by the
European Parliament to a European political group. The internal procurement rules adopted by the Bureau of the European Parliament and the European Parliament’s guidelines on their application, which these groups must follow, require the use of negotiated procurement procedures for high-value contracts. This is inconsistent with the Financial Regulation, which stipulates the use of open or restricted procurement procedures. The European Parliament’s internal rules limit competition, as they allow for the pre-selection of possible tenderers for high-value contracts and do not require the publication of a contract notice. Furthermore, we found that the political group did not fully follow these internal rules, as it did not seek enough tenders and did not adequately document the criteria it used to award the contract. We have previously reported shortcomings in transactions relating to procurement by political groups.

9.9. In addition, we examined a payment of €74.9 million related to the purchase of a building on Wiertz street in Brussels. The purchase was financed from funds unspent during the COVID-19 crisis and carried over from 2020. The Parliament started the corresponding purchase procedure in October 2020. When seeking offers, it used award criteria that weighted 50% of points for both price and quality of the proposed building. In line with the Parliament’s building strategy, proximity and easy access to its main Brussels site were important elements and represented 48% of the maximum weighting for quality. The Parliament received two offers and awarded the contract to the tenderer proposing the building on Wiertz street. While this building was significantly closer to the Parliament’s main site, it was 30% more expensive per square metre than the building proposed by the other tenderer. We consider that the European Parliament’s award criteria significantly reduced the importance of price as a basis for the purchase decision, making it unlikely that any other offer could have been accepted.

European Commission

9.10. We found one quantifiable error in payments made by the Commission, concerning a minor incorrect deduction from pension payments. Additionally, in two of the five pension payments audited by us we noted that the pension file did not contain a recent life certificate. Life certificates are necessary to show continuing entitlement to the pension and other allowances. The Commission had temporarily suspended verification checks on these certificates due to the COVID-19 pandemic.

---

4 Rules on the use of appropriations from Budget Item 400, last amended 6 July 2020.
5 See paragraph 9.11 of the 2015 annual report and paragraph 10.15 of the 2016 annual report.
European External Action Service

**9.11.** We found two quantifiable errors in payments made by the EEAS. One concerned the absence of an underlying contract for services acquired by an EU Delegation. The other related to allowances paid to a staff member who had not declared recent changes in their personal situation. We found similar errors in respect of family allowances paid by the Commission in previous years.\(^6\)

**Observations on supervisory and control systems**

**9.12.** We found no significant issues with the supervisory and control systems we examined at the EEAS (see paragraph 9.4(b)). Our specific findings regarding procurement and recruitment procedures at EU Delegations are reported in paragraphs 9.16-9.17.

---

\(^6\) See paragraph 9.9 of the [2020 annual report](#) and paragraph 9.9 of the [2019 annual report](#). These errors were later corrected by the Commission.
Annual activity reports and other governance arrangements

9.13. The annual activity reports we reviewed did not identify material levels of error, which is consistent with our audit findings (see paragraph 9.6).
Procedures for procurement and recruiting local staff at EU Delegations

9.14. In our 2015 annual report, we reported on significant weaknesses related to procurement and recruitment procedures organised by EU Delegations. This year we followed up these observations by examining a sample of ten procurement procedures and eight local recruitment procedures organised by EU Delegations. These were outside our representative sample and therefore did not contribute to our estimated level of error.

9.15. The EEAS made improvements to the procurement process through the simplification and modernisation of working procedures at EU Delegations, centralisation of some processes at headquarters, and creation of new templates for procurement documentation. It revised the rules and conditions governing the employment of local agents in EU Delegations in 2019, and performs ex ante controls before their recruitment. Nevertheless, we still detected weaknesses.

9.16. For five of the ten procurement procedures we examined, we found some deficiencies in how the EU Delegations applied public procurement rules. The mistakes concerned a lack of ex ante publicity for a low-value contract, use of an inappropriate method to score price, and the use of an inappropriate type of procurement procedure. We also found that the award criteria and their subsequent assessment were not always sufficiently precise.

9.17. We found some weaknesses in all eight of the recruitment procedures for local agents we examined. These included undocumented decisions by the selection board on the inclusion or otherwise of candidates on the shortlists, missing declarations regarding confidentiality and the absence of conflicts of interest, and insufficiently clear vacancy notices. We also observed that the EEAS did not provide guidance on candidate assessment and shortlisting. These may hinder the transparency of the recruitment process, the identification of the best candidates and equal treatment.
Conclusion and recommendations

Conclusion

9.18. The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘European public administration’ was not material (see Figure 9.2).

Recommendations

9.19. Annex 9.1 shows the findings of our follow-up review of the recommendation we made to the Commission in our 2018 annual report. A similar recommendation was included in the 2020 annual report7. The Commission has since taken action and implemented the recommendation in some respects.

9.20. Based on this review and our findings and conclusions for 2021, we recommend as follows:

Recommendation 9.1 – European Parliament

The European Parliament’s administration should revise its guidelines on the application by the political groups of the rules on public procurement, and it should propose a revision of these rules to the Parliament’s Bureau to better align them with the Financial Regulation. It should better monitor the application of these rules (see paragraph 9.8).

Timeframe: by the end of 2023

---

7 See recommendation 9.2 of the 2020 annual report.
Recommendation 9.2 – EEAS

The EEAS should take appropriate measures to ensure the application of procurement rules by EU Delegations such as enhancing training, improving guidelines and templates (see paragraphs 9.11 and 9.16).

Timeframe: by the end of 2023

Recommendation 9.3 – EEAS

The EEAS should enhance training and guidance on the EU Delegations’ recruitment procedures for local agents to ensure compliance with the principles of transparency and equal treatment. It should also strengthen its oversight that the EU Delegations document the relevant steps of the recruitment process (see paragraph 9.17).

Timeframe: by the end of 2023
## Annexes

### Annex 9.1 – Follow-up of previous recommendations for ‘European public administration’

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

We recommend that the Commission:

**Recommendation 1:**

improve[s] as soon as possible its systems for managing statutory family allowances by increasing the frequency of checks of staff members’ personal situation and reinforcing consistency checks on the declaration of allowances received from other sources, especially when there are reforms of family allowance systems in Member States.

---

### Source: ECA.

---

8 The monitoring of allowances received from elsewhere is complex, for reasons such as increasingly varied family situations and frequent changes in the national allowances in certain Member States. The Commission took action to improve its relevant IT systems and reinforce consistency checks, and recovers amounts it detected were overpaid. Our audit work continued to find errors.
Chapter 10

Recovery and Resilience Facility
# Contents

**Introduction** 10.1.-10.20.
**Brief description** 10.2.-10.15.
**Policy objectives** 10.2.-10.4.
**Implementation of the RRF** 10.5.-10.7.
**Management and control framework for the RRF** 10.8.-10.15.
**Audit scope and approach** 10.16.-10.20.

**Regularity of transactions** 10.21.-10.35.
- The Commission did not assess all criteria associated with the milestone 10.22.-10.28.
- Insufficiently robust criteria for the milestone related to the Member State’s control systems 10.29.-10.33.
- Insufficient documentation of the assessment process 10.34.-10.35.

**AARs and other governance arrangements** 10.36.-10.43.

**Conclusions and recommendations** 10.44.-10.46.
- Conclusions 10.44.-10.45.
- Recommendations 10.46.

**Annexes**
- Annex 10.1 – RRF payments in 2021
## Introduction

### 10.1. This chapter presents for the first time our findings on the Recovery and Resilience Facility ("RRF"). *Figure 10.1* gives an overview of RRF spending in 2021.

### Figure 10.1 – Payments and audit population

**Recovery and Resilience Facility**

<table>
<thead>
<tr>
<th>2021 audit population compared to total grant payments (billion euros)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2021 grant payments – total 46.4</strong></td>
</tr>
<tr>
<td>Pre-financing grant payments (*): 36.4</td>
</tr>
<tr>
<td>Grant payments based on milestones and targets: 10.0</td>
</tr>
<tr>
<td><strong>2021 audit population – total 11.5</strong></td>
</tr>
<tr>
<td>Clearing of pre-financing grant payments (*): 1.5</td>
</tr>
<tr>
<td>Grant payments based on milestones and targets: 10.0</td>
</tr>
</tbody>
</table>

(*) In line with the harmonised definition of underlying transactions (for details see *Annex 1.1*, paragraph 12).

*Source:* ECA.

### Brief description

#### Policy objectives

### 10.2. NextGenerationEU ("NGEU") is the EU’s temporary fund aimed at supporting Member States in reducing the socio-economic impact of the COVID-19 pandemic and getting back on track towards sustainable growth. Up to €750 billion in funding will be made available under NGEU: €390 billion in non-repayable grants, and €360 billion in loans (both at 2018 prices). The RRF is the main policy instrument under which NGEU funds will be distributed. It was established by Regulation (EU) 2021/241 ("the Regulation"). The RRF will be used to distribute €312 billion (80 %) of the non-repayable grants, which will be provided under NGEU. The remaining €78 billion (20 %) will be used to make additional allocations to, or "top-up", existing policy areas. *Annex 10.1* presents an overview of RRF grant payments (including pre-financing) per Member State in 2021.
10.3. The RRF provides large-scale financial support for public investments and reforms, in order to accelerate Member States’ economic recovery from the consequences of the COVID-19 pandemic, and to make them more resilient. Member States can use the RRF in the following six policy areas:

(i) green transition
(ii) digital transformation
(iii) smart, sustainable and inclusive growth
(iv) social and territorial cohesion
(v) health, and economic, social and institutional resilience, and
(vi) policies for the next generation.

10.4. In May 2022, the Commission published the proposal for the REPowerEU Plan, the EU’s response to global energy market disruption caused by Russia’s invasion of Ukraine. Its main objective is to end the EU’s dependence on Russian fossil fuels by transforming the EU’s energy system. The proposal involves targeted amendments to the Regulation to integrate dedicated REPowerEU chapters in Member States’ existing recovery and resilience plans (RRPs). Delivering the REPowerEU objectives requires an additional investment of €210 billion between now and 2027. This amount will be financed through €225 billion in loans already available that may be requested up until 31 August 2023. In addition, the RRF financial envelope will be increased by €20 billion, financed from the auctioning of Emission Trading System allowances.

Implementation of the RRF

10.5. To receive RRF funding, Member States are required to draw up national RRRPs that meet the conditions laid down in the Regulation\(^1\). RRRPs should comprise a coherent package of public investments and reforms grouped into components. Member States must set milestones and targets for each investment or reform, and provide details of the associated baseline. Member States must also provide the

---

1. Article 18(4) of the Regulation for the full set of conditions that RRRPs must satisfy.
estimated cost of the proposed measures, together with supporting documentation\(^2\). Figure 10.2 outlines the process for implementing the RRF.

**Figure 10.2 – RRF implementation process**

![Diagram of RRF implementation process](image)

Source: ECA.

10.6. Once a Member State’s RRP has been approved by the Council, the Member State may ask the Commission to release pre-financing up to 13\% either of the financial contribution in the form of non-repayable support, or of the amount of

\(^2\) Special report 21/2022 on “The Commission’s assessment of national recovery and resilience plans: overall appropriate but implementation risks remain” for our conclusions on the RRP assessment process for our conclusions on the RRP assessment process.
support to be provided as a loan. The pre-financing is cleared proportionally through the subsequent payments.

10.7. Further payments under the RRF are subject to Member States achieving the milestones and targets set out in the respective Council Implementing Decision (CID). Member States may request disbursements twice in a year, if they provide sufficient justification for the satisfactory fulfilment of the related milestones and targets. A further condition is that earlier achievements of targets or milestones must not have been reversed. The Commission’s assessment of the legality and regularity (regularity) of RRF payments therefore depends on these two conditions being fulfilled.

Compliance with national laws and EU rules, such as procurement rules or state aid, are not covered by the Commission’s regularity checks. This makes the RRF payments different from traditional MFF spending where the regularity of the Commission or Member State payment depends mainly on the eligibility of the beneficiary, project and costs claimed.

Management and control framework for the RRF

10.8. The Regulation sets out the Member States’ and the Commission’s roles and responsibilities in the set-up and implementation phases of the RRF (see Figure 10.3).

---

3 See Article 13 of the Regulation.

4 See Article 24 of the Regulation.
Figure 10.3 – Management and control framework for the RRF

Source: Commission.
**Member States’ responsibility**

10.9. The Member States were required to draw up their RRPs and design appropriate management and control systems. They must also collect data on the final recipients of funds, and ensure that the data are readily accessible\(^5\). To do so, they may use the Commission’s own data-mining and risk-scoring tool\(^6\). They can also use existing national management and control systems, or other systems used for related purposes, such as systems used for managing other EU funds. Member States RRPs must describe the different national bodies involved in detail.

10.10. During the implementation phase, Member States must submit the following with each payment request:

- information and evidence confirming achievement of the milestones and targets set out in the RRP;
- a summary of the audits carried out by the Member State authorities, including details of any weaknesses identified and any corrective action taken\(^7\);
- a management declaration\(^8\) to the effect that:
  - the funds were used for their intended purpose;
  - the information submitted with the request for payment is complete, accurate and reliable;
  - the control systems put in place provide the necessary assurance that the funds were managed in accordance with all applicable rules, in particular the rules aimed at preventing conflicts of interest, *fraud*, corruption and double funding.

---

\(^5\) Article 22(2)(d) of the Regulation.

\(^6\) Article 22(4) of the Regulation.

\(^7\) Article 6 of the financing agreement template. This specific requirement does not apply to the first disbursement request made after the request for pre-financing.

\(^8\) Article 22(2)(c) of the Regulation.
The Commission’s responsibility

10.11. The Commission is responsible for assessing the relevance, effectiveness, efficiency and coherence of Member States’ RRPs. This assessment includes the robustness of Member States’ proposed control systems.

10.12. The Commission’s control system must ensure that RRF payments are legal and regular which is contingent upon the satisfactory fulfilment of milestones and targets. To this end, it has set up a system that provides for *ex ante* verifications of Member States’ payment requests and *ex-post* audits in the Member States that are carried out after payment has been made.

10.13. The Commission assesses payment requests on the basis of the data and information provided by Member States. The purpose of this preliminary assessment is to ensure that the milestones and targets have been satisfactorily fulfilled. Based on this work, the Commission submits the preliminary assessment to the Council’s Economic and Financial Committee (EFC) for its opinion. Following this step, the Commission takes the final decision on whether to authorise the disbursement of funds (see *Figure 10.4*).

---

9 DG ECFIN’s 2021 annual activity report, p. 53.

10 Article 24(3) of the RRF Regulation.
10.14. The Commission must also ensure that the EU’s financial interests are protected – i.e. that the Member State is complying with its obligation to have processes in place to prevent and detect serious irregularities (i.e. fraud, corruption or conflicts of interest) or serious breaches of obligations under the financing agreement (including double funding)\textsuperscript{11}. To this end, at the time of the assessment of the payment

\begin{footnote}
\textsuperscript{11} Article 22(1) of the Regulation.
\end{footnote}
request, the Commission considers Member States’ management declaration and a summary of audits carried out. The Commission will also carry out systems audits and targeted *ex post* audits on the protection of the EU’s financial interest in the Member States.

10.15. The Commission can apply *financial corrections* (a reduction in the level of support provided, or recovery of funds already disbursed) if it finds:

- serious irregularities affecting the EU’s financial interests that have not been corrected by the Member State, or
- serious breaches of the conditions laid down in grant or loan agreements.

**Audit scope and approach**

10.16. The objective of our audit was to contribute to the statement of assurance and provide the basis for our opinion on the regularity of 2021 RRF expenditure.

10.17. Our audit population comprised the only 2021 disbursement, a payment to Spain, and the *clearing* of the related pre-financing (see *Figure 10.1*). The Spanish request for payment (dated 11 November 2021) included 52 milestones related mainly to reforms and some investments, which Spain reported as achieved. The amount in the CID determined to be payable to Spain was €11.5 billion. The Commission adopted its positive preliminary assessment on 3 December 2021 and, after receiving the positive opinion of the EFC, authorised the disbursement in its implementing decision of 22 December 2021. It paid €10 billion to Spain on 27 December 2021, simultaneously clearing pre-financing of €1.5 billion.

10.18. Our audit covered the regularity of the RRF payment made to Spain. We based our assessment on the condition for payment, i.e. that the milestones and targets as defined in the CID had been satisfactorily fulfilled (see paragraph 10.11). To do this, we examined whether the Commission had gathered sufficient and appropriate evidence to support its assessment of satisfactory fulfilment of the 52 milestones included in the Spanish payment request. Compliance with EU and national rules are not part of the regularity assessment (see paragraph 10.7) and neither is the assessment of the effectiveness of the reforms. We will cover this through dedicated special reports.
10.19. We also reviewed DG ECFIN’s reporting on the regularity of the relevant 2021 RRF expenditure in its AAR and the way this information is presented in the AMPR.

10.20. The design of the controls the Commission applies to protect the EU’s financial interests is part of a different audit task that is currently underway. We will present the results of this audit in a separate special report.
Regularity of transactions

10.21. This part of the chapter concerns our testing of this year’s transaction – the only RRF payment made in 2021, to Spain. We examined the Commission’s *ex ante* work on all 52 milestones associated with this payment and identified a number of weaknesses in the Commission’s assessment thereof. One weakness, the impact of which could not be quantified, affects the Commission’s assessment of satisfactory fulfilment in the case of milestone 395. The other weaknesses do not call its assessment of the other milestones into question.

The Commission did not assess all criteria associated with the milestone

10.22. The Commission based its assessment of satisfactory fulfilment of the milestones on the relevant elements contained in its description and in the related measure, both of which were set out in the related CID and the verification mechanism provided for in the operational arrangements.

10.23. This approach was also provided in the Commission's internal guidelines. According to these guidelines, as a rule, all elements contained in the description of the milestone/target in the CID as well as the elements included in the description of the measure in the CID should be considered.

10.24. Milestone 395, ‘Modifications of corporate income tax in 2021’ is the only milestone listed for reform 8 of component 28 in the Spanish RRP. We found that the Commission did not assess all elements provided for in the CID for this milestone (*Box 10.1*).
Box 10.1

Milestone 395 ‘Modifications of corporate income tax in 2021’

Description of milestone 395 (reform C28.R8) in CID Annex (p. 244):

"Entry into force of the modifications introduced by the Budget Law for 2021 and the development regulations related to Corporate Income Tax to increase corporate tax revenue."

Description of reform 8 (C28.R8) - Short-term adoption tax measures in corporate tax - in CID Annex (p. 241):

“The reform shall amend the Corporate Tax Act in order to increase the contribution of this tax to the support of public spending, while also introducing simplifications to the exemptions and deductions in order to ensure a minimum rate of 15 % by taxpayers. On the other hand, the exemption for dividends and capital gains generated by their shareholding in subsidiaries, both resident and non-resident in Spanish territory, shall be reduced by 5 %. The implementation of the measure shall be completed by March 31 2021.”

The Commission appropriately assessed the element on the reduction of the exemption for dividends and capital gains. However, it did not assess the element of the reform of a minimum rate of 15 %, as provided for in the CID description of the reform.

10.25. The Commission and Spanish authorities informed us that introducing amendments to ensure a minimum 15 % tax rate was a medium-term objective and had never been intended to be an element of milestone 395. It would instead be achieved through a number of other changes to the corporate income tax in the future, which includes the Budget Law that was adopted on 28 December 2021 and entered into force on 1 January 2022.

10.26. While we note that “ensuring a minimum 15 % tax rate” can be considered a mid-term objective, the documentation provided by the Member State and Commission’s assessment, however, did not refer to this element. The assessment did not provide any explanations why this element is not relevant for milestone 395 and how and when this element of the reform would be analysed and assessed. Despite that, the Commission assessed the whole milestone as satisfactorily fulfilled.

10.27. In such a situation, where a milestone is not fulfilled, the payment of all or part of the financial contribution (or loan, if applicable) should be suspended for a maximum of six months. Suspensions can only be lifted if Member States provide the
Commission with evidence of satisfactory fulfilment of the milestones or targets. If this does not happen within six months, the Commission should reduce proportionately the amount of the financial contribution or loan (if applicable).

10.28. However, it is not clear how the Commission and Member States arrived at the amounts of the different payments to Member States and how much each milestone or target contributed to this. In consequence, the compensation for achieving an individual milestone or target in the Spanish payment is unknown. To date, the Commission has not resolved this problem through adopting a method for calculating the amount of suspension of or reduction in payment. In the absence of such a method and quantitative information on milestones or targets, it is unclear how the Commission would implement Article 24 of the RRF Regulation and quantify the impact of milestone 395 not being achieved.

Insufficiently robust criteria for the milestone related to the Member State’s control systems

10.29. The adequacy of the Member States’ proposed monitoring and control systems was a condition for the approval of the RRPs. In its assessment of these plans, the Commission identified deficiencies in the Member States’ systems. In 2021, the Commission therefore required 16 Member States to include specific additional reforms and milestones in order to address those weaknesses\(^\text{12}\). The achievement of such milestones is a prerequisite for the implementation of the RRP and for the regularity of future RRF expenditure. Where milestones and targets are not clearly defined in the CID, there is a risk that they may be difficult to assess, and that they may not fulfil the objective which they are aimed at supporting.

10.30. For Spain, milestone 173 ‘Recovery and Resilience Facility Integrated Information System’ was one of the milestones introduced in relation to the Spanish control system. The Spanish authorities interpreted the requirements associated with the milestone as meaning that the system should be designed properly, but not necessarily be fully functional. The audit report required by the CID, to evidence the satisfactory fulfilment of this milestone, therefore concentrated on the design of the system, and not its actual operation. The Commission asked for supplementary information to verify whether the system was actually able to collect and store data on beneficiaries, contractors, subcontractors, and beneficial owners.

\(^{12}\) ANNEX XIV OF DG ECFIN’s 2021 annual activity report.
10.31. The Commission confirmed through its own testing that the system was able to perform these functions and assessed milestone 173 as having been satisfactorily fulfilled. However, in its assessment summary, it noted two remaining weaknesses in the manner in which the system dealt with information on beneficial ownership (in the case of foreign companies without a registered representative in Spain). These weaknesses had an impact on how this information was collected and how it could be accessed for control purposes.

10.32. The Commission discussed these issues with the Spanish authorities, who agreed on solutions to resolve them. The Spanish authorities stated that these solutions would take between six and nine months to implement. Nevertheless, even though the solutions were agreed on 1 December, the Commission already made a positive preliminary assessment of the payment request on 3 December. The Commission had not agreed any formal action plan with the Spanish authorities. Without such a plan, the timetable for corrective actions addressing remaining limitations of the system is not clear and their implementation is not ensured.

10.33. The wording of the CID allowed the Commission to consider the milestone had been satisfactorily fulfilled. While we do not put this assessment in question, it meant that some elements of the integrated information system had not been operational at the time of the assessment. The Commission intends to further examine this milestone in its ex post audits.

Insufficient documentation of the assessment process

10.34. An internal control system should include an adequate audit trail: full, transparent documentation of how the achievement of milestones and targets has been assessed. The Commission in its own note on the internal control setup for the RRF underlines this by stating that “Part of a complete control strategy is to establish document management (DM) rules to ensure the fullest possible transparency in working methods as well as to ensure complete audit trails”. The Commission in its audit trail documents the elements related to the satisfactory fulfilment of the milestone or target (see paragraph 10.7).
10.35. We found in the case of two milestones, that the audit trail was insufficient to cover all elements considered relevant in the assessment process. Box 10.2 provides an example of one such case.

Box 10.2

Example of the insufficient audit trail recording the assessment of the milestone


“The website shall collect data on tourism in Spain from various sources of tourism statistics including public and private bodies such as the INE, Turespaña, Bank of Spain, AENA or RENFE, and shall be operational.”

The Commission considered that all the elements of milestone 215 had been achieved, and concluded that the milestone had been satisfactorily fulfilled. In the analysis section of the summary assessment file, the Commission stated that the website associated with the milestone was operational and continuously collects and updates public tourism data from private and public bodies.

However, the audit trail of the assessment process for milestone 215 did not contain any evidence of the Commission’s verification that the website was collecting data from the main sources of tourism statistics.

---

AARs and other governance arrangements

10.36. AARs are the Commission DGs’ main tool for reporting whether they have reasonable assurance that control procedures ensure the regularity of expenditure. The Director-General’s declaration of assurance in DG ECFIN’s 2021 AAR includes RRF expenditure for the first time.

10.37. The Director-General’s 2021 declaration of assurance confirms that the control procedures put in place by DG ECFIN provide the necessary guarantees regarding:

(i) legality and regularity of the underlying transactions and

(ii) the implementation of Article 22(5) of the Regulation.

10.38. In 2021, DG ECFIN defined its audit and control strategies for the RRF and began to implement the new control framework for the Facility’s activities. In addition to the ex ante work, DG ECFIN approved its audit strategy in December 2021. The objective of the audit strategy is to confirm whether milestones and targets have been achieved and to assess whether the national authorities have set up the requisite management and control systems in relation to the regularity of payments and protection of EU financial interests in their implementation of the RRP.

10.39. The audit strategy provides for three types of ex post audits:

- audits concerning the achievement of milestones and targets (regularity);
- system audits that focus on data collection and reporting on milestones and targets in the Member States (regularity);
- system audits with respect to the protection of the EU’s financial interests.

10.40. The reasonable assurance on the regularity of the payment to Spain was based on comprehensive ex ante controls. Spain’s monitoring and control arrangements for the RRF are newly established. In line with the Commission’s control strategy, the related ex post audit or control results on the fulfilment of the additional commitments in relation to the control milestone (see paragraph 10.33) will become available at a later stage.
10.41. In contrast with other EU programmes, for the RRF the Commission makes a qualitative assessment of the control results and the level of risk associated with the operations, without any related estimate of error.

10.42. Expenditure under the RRF in 2021 is not part of the overall risk at payment for expenditure related to the MFF disclosed in the Commission’s AMPR. The Commission in a separate statement refers to the AOD’s declaration that he has reasonable assurance of the legality and regularity of the single RRF payment made in 2021. The assurance is based on the positive assessment of evidence for the fulfilment of the milestones of the payment request.

10.43. We note that the Commission’s internal audit service issued an emphasis of matter in relation to the RRF as part of its overall audit opinion in the AMPR. The emphasis of matter refers to certain elements of the design of the RRF control strategy covering legality and regularity that are still to be further elaborated in 2022.\textsuperscript{14}

\textsuperscript{14} Annex VI of volume III of the 2021 AMPR.
Conclusions and recommendations

Conclusions

10.44. The overall audit evidence we obtained through our work and have presented in this chapter indicates that one of the milestones associated to the first disbursement to Spain was not satisfactorily fulfilled. The Commission has not yet defined a method for quantifying the impact of not achieving a milestone or target. Our own view is that the error is not material.

10.45. Other weaknesses found in the Commission’s work when assessing the milestones, concern insufficiently robust criteria for the milestone and insufficient documentation of its work, though this does not affect the assessment of the achievement of the milestone.

Recommendations

10.46. Based on our findings and conclusions for 2021, we recommend that the Commission:

Recommendation 10.1 – Justify non-relevant elements for the assessment of milestones and targets

Clearly and transparently justify the elements contained in the Operational Arrangements and CID that are not considered to be relevant by them for the satisfactory fulfilment of milestones and targets.

Target implementation date: Immediate

Recommendation 10.2 – Develop a methodology for the (partial) suspension of a payment

Develop a methodology to determine the amount to be suspended in accordance with Articles 24.6 and 24.8 of the Regulation.

Target implementation date: Immediate
Recommendation 10.3 – Improve documentation of the assessment of milestones and targets

Improve documentation of the assessment of milestones and targets by fully documenting all the elements examined during the *ex ante* work.

**Target implementation date:** Immediate
## Annexes

### Annex 10.1 – RRF payments in 2021

<table>
<thead>
<tr>
<th>Member States with RRP approved</th>
<th>RRF grant pre-financing</th>
<th>RRF grant disbursements excluding pre-financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>9,037</td>
<td>10,000</td>
</tr>
<tr>
<td>Italy</td>
<td>8,954</td>
<td>-</td>
</tr>
<tr>
<td>France</td>
<td>5,118</td>
<td>-</td>
</tr>
<tr>
<td>Greece</td>
<td>2,310</td>
<td>-</td>
</tr>
<tr>
<td>Germany</td>
<td>2,250</td>
<td>-</td>
</tr>
<tr>
<td>Romania</td>
<td>1,851</td>
<td>-</td>
</tr>
<tr>
<td>Portugal</td>
<td>1,808</td>
<td>-</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>915</td>
<td>-</td>
</tr>
<tr>
<td>Slovakia</td>
<td>823</td>
<td>-</td>
</tr>
<tr>
<td>Croatia</td>
<td>818</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>770</td>
<td>-</td>
</tr>
<tr>
<td>Austria</td>
<td>450</td>
<td>-</td>
</tr>
<tr>
<td>Lithuania</td>
<td>289</td>
<td>-</td>
</tr>
<tr>
<td>Latvia</td>
<td>237</td>
<td>-</td>
</tr>
<tr>
<td>Slovenia</td>
<td>231</td>
<td>-</td>
</tr>
<tr>
<td>Denmark</td>
<td>202</td>
<td>-</td>
</tr>
<tr>
<td>Cyprus</td>
<td>131</td>
<td>-</td>
</tr>
<tr>
<td>Estonia</td>
<td>126</td>
<td>-</td>
</tr>
<tr>
<td>Malta</td>
<td>41</td>
<td>-</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>12</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: ECA, based on data from the Commission’s Recovery and Resilience scorecard.*
Institutions’ replies to the annual report on the implementation of the EU budget for the 2021 financial year
Contents

Chapter 1  The statement of assurance and supporting information

European Commission’s replies  282

Chapter 2  Budgetary and financial management

European Commission’s replies  291

Chapter 3  Revenue

European Commission’s replies  296

Chapter 4  Single Market, Innovation and Digital

European Commission’s replies  302

Chapter 5  Cohesion, resilience and values

European Commission’s replies  310

Chapter 6  Natural resources and environment

European Commission’s replies  325

Chapter 7  Migration and border management
  Security and defence

European Commission’s replies  330

Chapter 8  Neighbourhood and the world

European Commission’s replies  335
Chapter 9  European public administration
  European Parliament's replies  339
  European Commission’s replies  341

Chapter 10  Recovery and Resilience Facility
  European Commission’s replies  342
INTRODUCTION TO THE COMMISSION REPLIES

The year 2021 witnessed the successive easing of restrictions imposed during the global pandemic, but also revealed the real dimension of social and economic costs caused by COVID-19.

The EU budget has largely contributed to cushion the economic impact of the pandemic and to make the European economies stronger and more resilient. NGEU and the Recovery and Resilience Facility are only two examples of the united response by the EU in the face of COVID-19.

Also, in these exceptional times, the Commission continued to attach great importance to ensuring that the EU budget was spent responsibly and correctly, and to working with all parties involved, including Member States to make sure that it delivers tangible results on the ground.

The Commission carefully monitors the implementation of the EU budget. If Member States, intermediaries or final beneficiaries are found to have spent EU money incorrectly, the Commission takes immediate steps to correct these errors, and recover the funds as necessary.

The implementation of the EU budget entails handling millions of transactions, and hundreds of thousands of checks, across all programmes and management modes. The Commission endeavours to strike the right balance between a low level of errors, fast payments and reasonable costs of controls.

While the financial management of the EU budget has improved over time, some types of expenditure remain more error-prone. These are mostly governed by more complex rules and reimbursement schemes. The Commission continues to identify where issues are, take preventive and remedial measures to address the weaknesses identified and ensure that errors are better prevented and detected over time for all programmes.

AUDIT FINDINGS FOR THE 2021 FINANCIAL YEAR

Reliability of the accounts

1.8 The Commission welcomes that the EU accounts are considered to be free from material error for the 15th year in a row.

Regularity of transactions

1.18 a) As regards the revenue side of the EU budget, the Commission welcomes that the European Court of Auditors (ECA) considers revenue continues to be free of material error.
The Commission also welcomes that the ECA considers that revenue-related systems examined were generally effective. As it does with its own findings, the Commission will follow up on the issues identified by the ECA's audit in certain Member States, which will be required to take appropriate measures to address and resolve the shortcomings identified.

The Commission will continue to intensify the follow-up on longstanding open TOR points and lifting VAT reservations where possible.

Regarding the actions to reduce the customs gap, the Commission notes that while the overall objective of the Customs Action Plan is not to reduce this gap, several actions in the Action Plan do have the ambition to contribute to this objective (See also Commission reply to paragraph 3.13).

b) As regards regularity of expenditure, based on the numerous audits and controls carried out, the Commission’s own estimate of the risk at payment, i.e. the remaining level of error at the time of payment, after its preventive controls, remained stable at 1.9% of the relevant expenditure, i.e. the same level as in 2020. This stability is consistent with the fact that most of the expenditure in 2021 still relate to the 2014 – 2020 programming period.

Given the multiannual nature of its expenditure and of its control strategies, the Commission deploys substantial efforts to perform controls after the payments and to continue to make corrections. These efforts are reflected in the estimated risk at the closure of the programme, which is at 0.8% overall (0.9% in 2020). This is well below the materiality threshold of 2% and in line with both the levels reached in previous years since 2016 and with the objective of the Commission.

Thanks to the wealth of information gained through its controls and its detailed analysis thereof, the Commission is able to split the expenditure for which the risk at payment is above 1.9% between:

- medium risk expenditure, with a risk at payment between 1.9% and 2.5%, representing 23% of the total expenditure and,
- higher risk expenditure, with a risk at payment above 2.5%, representing 22% of the total expenditure for 2021.

Accordingly, the Commission concludes that more than half of the expenditure (55%) are low risk as the risk at payment is below the materiality threshold (See details in the Annual Management and Performance Report 2021, Volume II, page 50).

Impact on the risk of error of complexity of rules and of the way EU funds are disbursed

1.19 – first indent The Commission shares the conclusion that the risk of error is lower for expenditure subject to simplified rules (mainly in entitlement-based payments). Therefore, the Commission has strived to pursue its simplification efforts to the greatest possible extent when designing the 2021-2027 programmes, especially in the areas of research and innovation and in cohesion policy, by promoting the use of simplified cost options as well as the financing not linked to costs schemes, and with the CAP new delivery model.

---

1 As there is no closure of the European Agricultural Guarantee Fund measures, in the area of agricultural expenditure the risk at closure is replaced by the final amount at risk.
Second indent While the complexity of rules may contribute to a higher risk of errors, the Commission considers that the control systems in place allow the risks related to some of the more complex programmes to be mitigated.

The Commission is taking targeted remedial actions for the medium- and higher-risk categories in particular. Such actions include raising beneficiaries’ and implementing partners’ awareness of applicable EU rules and of recurrent issues, adjusting the control strategies where necessary, applying the lessons learned to future programmes and simplifying rules wherever possible.

At the same time, complex conditions and eligibility rules may be needed where, in order to achieve ambitious policy objectives, targeting of aid is necessary, or in order to respect basic principles of the Single Market (public procurement or State aid rules).

Legality and regularity must therefore be balanced with the achievement of policy objectives while bearing in mind the delivery costs.

1.20 The Commission shares the view of the ECA according to which the way funds are disbursed has an impact on the risk of error.

However, based on the detailed information at its disposal, the Commission considers that the risks at payment are not uniformly material for reimbursement-based payments. The risk exposure might differ within the same policy area and even within the same spending programme.

High-risk expenditure

1.22 - 1.23 Based on its detailed assessment, the Commission splits its expenditure according to their estimated risk at payment. On this basis, the Commission considers that for 45% of its relevant expenditure, the risk at payment is above 1.9%, which is stable compared to 2020.

This relates to some operational programmes for ‘Cohesion’, i.e. only those that show serious deficiencies and/or have error rates above 1.9%; the grants for the research programme Horizon 2020 and other complex grants in the same MFF heading; individual CAP paying agencies for direct payments and rural development as well as some Member States for market measures that have error rates above 1.9%.

See also Commission reply to paragraphs 1.19 and 1.20.

1.24 In the policy area of ‘Cohesion, resilience and values’, Based on a common typology, the Commission and the audit authorities identified generally the same categories of irregularities as the ECA: ineligible expenditure, public procurement, audit trail and State Aid.

The Commission is taking actions with programme authorities, responsible in first instance to prevent and detect errors, through capacity building actions and audits, to reduce the errors. The Commission addressed updated guidance, which, combined with the required use of simplified costs options, aim at improving further the quality of management verifications.

The Commission is also implementing its action plans in relation to Public Procurement and State aid. These actions aim at helping administrators and beneficiaries of EU funds improve their public procurement practices and reduce the risk of irregularities linked to the application of State aid rules through training programmes and dissemination of relevant information to ESI Funds stakeholders. Finally, remedial action plans requested from the concerned programme authorities
each time deficiencies are found, also contribute to improving systems for the concerned programmes.

1.25 Concerning the policy area of ‘Natural Resources and environment’, for market measures and rural development, the ECA’s assessment is in line with the Commission’s one, which also sees higher risk of errors in these areas. Under the current CAP legislative framework, complex conditions and eligibility rules apply where, in order to achieve ambitious policy objectives, targeting of aid is necessary. It is thus needed to balance legality and regularity considerations with the achievement of policy objectives while bearing in mind the delivery costs. For the 2023-2027 period, the Commission is addressing this by promoting the use of Simplified Cost Options and by simplifying the CAP.

1.26 In the area of ‘Research and Innovation’, funding based on actual costs remains relatively complex and error prone, in particular for certain types of beneficiaries (see paragraph 1.19) despite the Commission efforts to provide guidance to all participants.

In addition, as alternative to funding based on actual costs, the Commission is promoting an increased use of lump sums and a unit cost system for personnel costs available in any grant, which is the main source of errors.

1.27 Referring to ‘Neighbourhood and the world’, the Commission considers that the lower-risk expenditure under this chapter is not limited to merely the budget support payments and to administrative expenditure, but includes also other expenditure under direct and indirect management segments that have a low or medium risk at payment.

Typology of errors: eligibility and infringements of state aids and public procurement rules

1.28 The typology of errors reflects the complexity of rules. The Commission is therefore continuously working to simplify rules to the extent possible and increase the use of simpler delivery mechanisms such as simplified cost options. Reducing red tape for beneficiaries and reducing complexity is one of the guiding principles for the 2021-2027 Multiannual Financial Framework. See also Commission reply to paragraph 1.19.

1.29 Regarding the cases of eligibility errors identified by the ECA in the Cohesion policy funds, the Commission considers that for two transactions in relation to one programme, there is no legal basis for imposing financial corrections. The Commission also notes that one-third of the ECA’s estimated level of error refers to just one national programme addressing youth unemployment and reflects a very specific issue. The Commission also refers to its reply to paragraph 5.15 and 5.22.

As regards Research and Innovation, the Commission notes that “ineligible projects” is not a common source of errors for this policy area.

1.30 The Commission notes that, over the past years, errors related to State aid rules identified by Member States authorities and the Commission have remained less frequent as far as the Cohesion policy funds are concerned, which shows the impact of the measures designed under the Commission’s State aid action plan.

Public procurement remains an important source of error reported by audit authorities, which nowadays better detect such issues as a sign that the administrative capacity actions implemented
under the Commission’s action plan on public procurement also bear fruit. The Commission refers to its replies to paragraphs 5.27 and 5.29.

Low-risk expenditure

1.32 Based on its detailed assessment, the Commission considers that the (parts of) funding programmes that are low risk, meaning that the associated risk at payment is below 1.9%, represent, as in 2020, around 55% of the relevant expenditure in 2021.

This includes the expenditure of the vast majority of CAP paying agencies and the European Maritime and Fisheries Fund as well as some operational programmes for ‘Cohesion’, i.e. those with a low error rate; expenditure related to the Marie Skłodowska-Curie actions; the European Research Council grants; the European Space Agency and the European GNSS Agency; the Connecting Europe Facility; Erasmus+; the Asylum, Migration and Integration Fund; budget support, subsidies and administrative expenditure.

In the area of ‘Natural Resources and environment’, the Commission is satisfied with the ECA’s conclusion (as also indicated in Chapter 6) that EAGF direct payments, representing 68% of spending under natural resources, continues to be free of material error This is in line with the Commission’s own conclusions in the Annual Activity Report of DG AGRI concerning the CAP expenditure.

The Commission’s regularity information

The Commission’s estimate of error

1.36 – 1.38 By building its assurance from the bottom up and at a detailed level, i.e. by programme or other relevant segment of expenditure, since implementation is not homogenous across programmes and Member States, the Commission’s objective is to identify where issues are to take appropriate remedial actions accordingly.

The Commission is confident about the information regarding risks at payment and risks at closure presented in the AMPR. They are based on hundreds of thousands of checks carried out every year by the Commission and the Member States, following their carefully established control strategies, tailored to the specificities of the spending programmes.

The Commission is closely monitoring the risk at payment and risk at closure, with the objective to maintain the risk at closure below the materiality threshold of 2%.

The Commission also notes that its approach, as manager of the EU budget, is different from that followed by the ECA in its role of external auditor. This may result in some differences between the estimation of the level of error by the two institutions.

In addition, the Commission does not always share the ECA’s assessment on individual errors.

Based on the work carried-out, the Commission considers that the risk-at-payment presented in the AMPR for MFF1 ‘Single market, innovation and digital’ is representative of the level of error (see points 4.6 and 4.29, in Chapter 4).

For the area of ‘Cohesion, resilience and values’ the Commission notes that the maximum value of its error estimate for MFF heading 2 (2.3%), that is considered in the AMPR for the calculation of the Commission’s overall risk at payment, falls within the ECA’s error range estimate for the third year in a row.
For heading 3 'Natural resources and the environment', the Commission welcomes ECA’s estimate of the error rate at 1.8%, which is below the materiality threshold and in line with its own assessment of the risk at payment.

1.39 The Commission continues to take actions to improve the effectiveness of ex-post checks.

For instance, in the area of Research and Innovation, the Commission’s Common Audit Service has been working on the aspects pointed out by the ECA in past reports. Most of the actions to tackle these issues are implemented and the Commission will continue working on them.

In the area of Cohesion policy, the Commission considers that, overall, reliance can be placed on the work of audit authorities and their control bodies, with the exception of a limited number of them as reported in the Annual Activity Reports. In some cases, additional errors detected are occasional and do not point to a systemic weakness at the level of the audit authority.

The Commission has continued in 2021 to extensively cooperate with Member State audit authorities to ensure a consistent and robust assurance and control framework, including under conditions of practical restrictions for audits during the pandemic, and to improve the quality of the assurance work as needed, strengthening the necessary detection and corrective capacities.

**The Commission’s risk assessment**

1.40 - 1.41 As explained in the reply to paragraph 1.36, the Commission is confident about the information regarding risks at payment and risks at closure presented in the AMPR.

In the area of Research and Innovation, the Commission’s Common Audit Service has implemented actions to duly address the ECA recommendations on the ex-post audits as well as on the methodology for calculation of the error rate for Horizon 2020. On this basis, the Commission is confident with the result of the error rate calculated for this MFF heading.

Given its more detailed segmentation of expenditure according to risk profiles and control systems under 'Cohesion, resilience and values', the Commission, when detecting errors, and taking also account of the ECA’s work, is able to identify the specific part of the programme population that is most likely to be affected by errors. It is thus able to give a differentiated view of the level of error across the payments made and to clearly identify the areas where improvements are needed.

The Commission is convinced that its detailed assessment based on a combination of desk and on-the-spot audit work covering the different individual programmes and assurance packages, depending on the risks attributed to them, enables it to establish a reasonable and fair estimate of the error rates for each programme and cumulatively for all programmes.

To address the risk of remaining undetected errors, the Directorates-General also calculate a maximum value of their Key Performance Indicator on legality and regularity of expenditure, which is used to estimate the risk at payment for Cohesion policy and for heading 2 in the AMPR.

In the policy area 'Neighbourhood and the world', the Commission considers that the RER study is fit for purpose and is not subject to limitations that may contribute to an under-estimation of errors.

**The Commission’s reporting on financial corrections and recoveries**
1.43 For the AMPR 2021, the Commission has made significant efforts to provide a complete and transparent picture of all the measures implemented during the financial year, both preventive and corrective, by both the Commission and the Member States. The Commission welcomes the acknowledgement by the ECA that the revision has led to a simplification of the reporting on financial corrections and recoveries and a clarification of the amount of irregular expenditure corrected and returned to the EU budget.

1.44 The Commission agrees that the majority of net corrections and recoveries concerns the period 2014 – 2020. Out of the € 631 million of net corrections and recoveries for Natural Resources, at least almost € 439 million (69%) are related to the period 2014 – 2020. This amount represents 57% of the total amount of net corrections imposed on the Member States of € 765 million.

For Cohesion, the Commission’s corrections are implemented from the 2014-2020 MFF onwards at the level of the Member States, ensuring timely and efficient implementation. The assurance model is focused on ensuring a 2% error level by programme. No net financial corrections were implemented so far due to the very restrictive criteria to be met as set by the co-legislator. However, this new provision introduced in the 2014-2020 period continues to work as an incentive for Member States to carry out financial corrections in first instance, before submission of the annual accounts.

1.45 Member States preventive measures are not attributed to the Commission directly. Nevertheless, for the reasons explained in the reply to paragraph 1.44, the Commission considers that the corrective capacity should also include those corrections implemented by the Member States following a request from the Commission.

The Commission has transparently explained how the percentage of 3.3 % is obtained and what the different components of the €5 620 million are in the AMPR. (See AMPR 2021, Volume III, Annex 5, p 31 and Volume II, Annex 2, p. 44).

The Commission notes that in order to ensure a comprehensive overview of all applicable control layers pursuant to the existing financial and legal framework, measures taken by the Member States should also be considered. They were already reported in the past, though presented separately. For Cohesion the corrections presented were those related to the audit authorities.

**The impact of the rule-of law procedure on the regularity of 2021 expenditure**

1.46 The Commission considers it necessary to address a notification against Hungary under Article 6(1) of the Conditionality Regulation in order to protect the Union’s financial interest from current or future risks and address the widespread and intertwined irregularities and deficiencies identified in that Member State.

Before 2021, the Commission could only use the measures foreseen by the sectoral legislation to address these irregularities and deficiencies. It made an extensive use of these measures, as evidenced by the magnitude of the financial corrections imposed to HU over time, together with longstanding recommendations and requests. However, these measures generally related to expenditure already declared to the Commission and did not allow to completely prevent the continuation of these or similar irregularities and deficiencies, and change the system in a structured manner, for many years.

The entry in 2021 into force of the Conditionality Regulation complemented the sectoral legislation with a wider instrument allowing to deal with such deficiencies in a structured manner over time. A
notification under the Conditionality Regulation is however only the first step in the procedure and the Member State may submit information that may dispel the concerns and/or it may submit remedial measures that address such concerns. The procedure for adopting measures to protect the Union's financial interest and for lifting those measures must respect the principles of objectivity, non-discrimination and equal treatment of Member States and be conducted according to a non-partisan and evidence-based approach. The Commission may only propose measures to the Council who is responsible for their adoption.

For all the above reasons, the Commission cannot anticipate measures eventually adopted by the Council. It is therefore for the Commission only to report action taken at corporate level in the Annual Management and Performance Report (AMPR).

REPORTING OF SUSPECTED FRAUD TO OLAF AND THE EPPO

1.53 Regarding the CAP, and building on the work already done in the framework of the fraud related recommendation in the ECA 2019 Annual Report, the Commission will do the necessary to implement the recommendations made by the ECA in its Special Report 14/2022 – “The Commission’s response to fraud in the common agricultural policy - Time to dig deeper”.

Regarding the audit authorities’ work in Cohesion policy, the Commission welcomes the improvement reported in paragraph 5.49 in the use of checklists that explicitly address the risk of fraud. The Commission stresses the importance of the ongoing implementation, together with programme authorities, of the Joint Anti-Fraud strategy, developed with the collaboration of OLAF, in line with the Commission’s zero-tolerance-to-fraud principle. It includes in particular the promotion and continuous enhancement of the data-mining and risk scoring tool Arachne, currently put at the disposal of Member States on a voluntary basis, and recently included in the proposed revision of the Financial Regulation for compulsory use.

CONCLUSIONS

1.53 - 1.58 The Commission stresses that it attaches great importance to sound financial management of the EU budget. As manager of the EU budget, the Commission has put in place robust, multiannual control strategies designed to prevent, detect and correct weaknesses identified. It is continuously adjusting, developing and improving them and also takes action to strive for further simplifications across programmes. The Commission also notes that its approach, as manager of the EU budget, is different from that followed by the ECA in its role of external auditor. This may result in some differences between the estimation of the level of error by the two institutions.

The Commission welcomes that the EU accounts are considered to be free from material error for the 15th year in a row. Concerning the revenue side of the EU budget, the Commission considers, in line with the ECA, that it is free from material error.

Concerning the expenditure, the Commission welcomes ECA’s estimate of the error rate at 1.8 % for the policy area “Natural Resources and environment”, which is below the materiality threshold and in line with the Commission’s own assessment of the risk at payment. The Commission also concurs with the ECA’s overall conclusion that the level of error in spending on ‘European public administration’ was not material.
The Commission is confident about the information regarding the levels of error and risks at payment presented in the AMPR. The Commission considers, in addition, that the error rate that represents best all the efforts made, both by the Member States and by its services, is the risk at closure (see also reply in paragraph 1.34) which measures the level of error remaining once all ex-post controls and corrections have been made. For 2021, the overall risk at closure is estimated at 0.8%, well below the 2% materiality threshold, and in line with previous years’ level (0.7% in 2019 and 0.9% in 2020).

In addition, thanks to its own detailed management analysis per programme (see also reply to paragraph 1.18 b), the Commission is able to have a nuanced picture of the level of risk within policy areas and within spending programmes. This demonstrates that the risks at payment are not homogeneously low, medium or high for a given policy area (see AMPR 2021, Volume II, p 50).

- Such an approach enables the Commission to identify precisely where the risks and their root causes are, and to take targeted corrective measures: lower risk expenditure, those with a risk at payment below 1.9%, represent 55% of the total expenditure,
- medium risk expenditure, with a risk at payment between 1.9% and 2.5%, represent 22% of the total expenditure and,
- higher risk expenditure, with a risk at payment above 2.5% or serious weaknesses identified, represent 23% of the total expenditures.

This contributes to the Commission’s conclusion that the risk at payment is below the materiality threshold for more than half of the relevant expenditure.

Finally, as regards the reporting on financial corrections and recoveries, the Commission has brought improvements, as acknowledged by the ECA.
INTRODUCTION TO THE COMMISSION REPLIES

The Commission underlines that all necessary measures were taken to ensure full and efficient implementation of the EU budget in accordance with the existing financial and legal framework.

The 2021 EU budget was the first one under the new 7-year Multiannual Financial Framework (MFF 2021-2027). Late adoption of the MFF Regulation (17 December 2020) led to the adoption of the legal acts of the new generation of programmes only in the course of the year. This affected budget implementation in 2021, delaying the start of the activities of many programmes and implementation steps (calls, selections, contracting) and, consequently, payments. Moreover, the continued particular circumstances caused by the COVID-19 pandemic had a significant impact also on the completion of the pre-2021 programmes and instruments across the EU budget. A significant part of the commitment appropriations was carried over or reprogrammed to be implemented in 2022-2025.

The level of outstanding commitments (‘reste à liquider’ – RAL) stemming from the current MFF and its predecessors was reduced at the end of 2021 compared to the year before. This is largely due to the reprogramming of the 2021 allocations as well as the accelerated payments for ongoing programmes in cohesion policy. The nominal increase of the value of the RAL at the end of 2021, as compared to 2020, is linked to the implementation of NextGenerationEU (NGEU).

As regards increased risks and challenges for the EU budget, the risk from the growth of contingent liabilities related to SURE is negligible. Guarantees of EUR 25bn provided by Member States that underpin SURE are its first layer of defence, covering 2.5 years of EU exposure. In addition, SURE has other safeguards. Specifically, its portfolio of loans is constructed to limit concentration risk, annual exposure and excessive exposure to individual Member States. In addition, if needed, the Commission can also roll over the associated borrowings.

As regards the increased risks to the EU Budget entailed by Russia’s invasion of Ukraine, the Commission presented on 18 May 2022 a package related to the topics that emerged because of this war, from energy security of supply to EU’s defence investment gap and support to Ukraine. All these topics may have implications on future EU budgets; however, they do not pertain to the implementation of the 2021 financial year.

BUDGETARY AND FINANCIAL MANAGEMENT IN 2021

Budget implementation

Impact of late adoption of regulations on implementation of commitment appropriations

2.5 The low implementation rate of commitment appropriations in 2021 does not mean that the unimplemented appropriations lapsed. It means that they will be implemented in the following
years, in line with the MFF Regulation and the relevant basic acts. For what concerns funds in shared management, the needs and possibility for transferring the 2021 commitment tranche to later years was already foreseen in the MFF Regulation.

In fact, the Commission was able to make sure that the 2021 budget appropriations were or will be fully implemented thanks to the reprogramming of the programmes under shared management in accordance with Article 7 of the MFF Regulation, to the carry-overs in line with the Financial Regulation and other relevant basic acts, and to the full implementation of the remaining budget available.

2.8 As a consequence of delays in adopting sectoral legislation, no programmes were approved in 2021 and therefore the 2021 tranche of commitments under the CPR programmes was reprogrammed to 2022-2025.

It has to be stressed that the main reasons for the delayed programming was not only the delayed legislation but also the conflicting priorities of the Member States who needed to firstly deal with the crisis entailed by the COVID pandemic and its aftermath, and therefore focused on re-programming the 2014-2020 programmes based on the possibilities embedded in CRII(+) and REACT-EU, as well as on the preparation of the national Recovery and Resilience Plans.

Absorption of 2014-2020 ESIF funds

2.14 – 2.16 and Figure 2.2 The Commission would like to point out that, for the European Agricultural Fund for Rural Development (EAFRD), the actual absorption for the 2014-2020 funds, as allocated at the start of the programming period, is 79%, a very well performing level. The situation presented by the ECA in Figure 2.2 includes additional resources allocated from the MFF 2021-2027 for the years 2021 and 2022. Had this not been the case, the real situation for each Member State would also be different from what is presented in Figure 2.3.

As such, the cumulative situation presented includes 2014-2020 ESIF programmes with two years left for implementation (31 December 2023), except for the EAFRD where the existing programmes will continue until the end of 2025. The Commission therefore points out that the implementation delays described do not relate to the EAFRD.

Budgetary transfers

2.19 The observed increase in the value of transfers was mostly due to specific situation in 2021 (delayed start of new programmes, persistent consequences of the COVID-19 on projects implementation) and they mostly related to a fine-tuning of needs to ensure full implementation. Transfers (adjustments) in commitments were done mostly to facilitate maximum execution of the budget and to react to unforeseen circumstances, to reflect the final adoption of the relevant basic acts (to align the amounts in the budget with what was finally adopted), and to cater for the late adoption of such basic acts.

Outstanding commitments from the EU budget and NGEU

2.26 The Commission points out that another important driver for the decrease in outstanding commitments from 2020 to 2021 was the accelerated payments for 2014-2020 programmes under cohesion policy. The delayed launch of 2021-2027 cohesion policy funds implied that the newly generated RAL for the 2021 financial year was more limited.

---

1 COM(2022) 81.
2.31 The Commission also measures “Reste à Liquider” (RAL) against the size of the EU economy. From the end of 2021 to the end of 2027, the ratio between the RAL (excluding Next Generation EU) and EU GNI is projected to fall from 1.7% to 1.6%. Moreover, the RAL is primarily related to when payments from the EU to beneficiaries are due, and it is partially a natural consequence of the EU's budgeting system with different commitment and payment appropriations.

2.32 The Commission monitors the implementation of the budget and the evolution of the overall level of outstanding commitments (RAL), as well as the related underlying factors. It regularly informs the European Parliament and the Council of the forecast needs and potential risks for the future. This information is included notably in an annual report on the long-term forecast on the future inflows and outflows of the EU Budget 2021-2027, which is part of the Integrated Financial Accountability Reporting (IFAR) under Article 247 of the Financial Regulation.

The Commission prepares its forecast based on a wide range of available data (the execution of the previous years' budgets, the implementation and latest developments of the actual budget and the future needs presented in the draft budget for the following year). In addition, the Commission takes into account Member States’ forecasts for the implementation of the cohesion policy funds – the main driver behind the overall payment estimates under the MFF. The Commission will continue to propose adequate levels of payment appropriations in the framework of the annual budgetary procedures in order to meet the payment needs. However, the Commission recalls that the adoption of the budget appropriations lies ultimately within the remit of the budgetary authority.

COVID 19 reporting

2.39 As indicated in the replies to the ECA Annual Report for financial year 2020, the Commission focuses on the recovery from the COVID-19 pandemic and fulfil its reporting obligations, in particular, for NGEU. The Commission does not intend to prepare further reporting on the immediate response beyond the already existing reports of the various instruments.

RISKS AND CHALLENGES

Implementing various budgetary instruments in parallel

2.40 The Commission will work jointly with the Member States to identify the implementation risks and to minimise them – through daily work with the managing authorities, the monitoring committees, the annual performance review meetings, ad hoc communication, possible action plans etc.

The Commission also points out that implementation issues referred to in paragraph 2.40 do not concern the two agricultural funds (EAFRD and EAGF), for which a transitional period for 2021 and 2022 was adopted.

2.41 As stated in its reply to recommendation 2.3 of ECA’s 2020 Annual Report, the Commission reiterates that it already provides significant advisory support to Member States under shared management, and will continue to do so. As regards additional risks that could arise in the context of the crisis entailed by the COVID-19 pandemic, and of the additional funds allocated to Member States, the Commission stresses that it has provided further targeted support to programme managing authorities to address the situation and worked in parallel with the audit authorities to ensure a robust and harmonised audit approach. Despite the situation, a clear message was passed to programme authorities that compliance with rules remains a prerequisite.
The Commission continues to carefully assess the situation and the possible impact of a prolonged crisis on the assurance process and provides support to all programme authorities on an ongoing basis to improve their administrative capacities.

As regards the EAFRD, the Commission adopted Implementing Regulation (EU) No 2020/532 which provides rules with realistic and attainable control requirements for the Member States in the area of the common agricultural policy. The amended rules were limited in time and scope and proposed alternative methods to carry out the controls by the Member States under the COVID-19 restrictions and as such, together with the work of the Certification Bodies, continued to provide a good basis for assurance.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

2.55 As regards the implementation of commitments, the main reason for the delayed programming was not only the delayed adoption of the legislation per se but also the COVID pandemic and the conflicting priorities since Member States firstly had to deal with the crisis and its aftermath. They therefore focused on re-programming 2014-20 programmes based on the possibilities embedded in CRII(+) and REACT-EU and on the preparation of the Recovery and Resilience Plans.

The Commission recalls that the agricultural funds are not affected by a delayed launch of new programmes, considering the transition period adopted for 2021-2022.

2.56 As regards payments, they accelerated in 2020 and 2021 in large part due to the significant reprogramming effort made under the Coronavirus Response Investment Initiative (CRII) and of the Coronavirus Response Investment Initiative Plus (CRII+) in 2020-21. The possibility of temporary 100% EU co-financing provided by CRII+ was used by 17 Member States (and ETC) in 179 programmes with an impact of EUR 12.9 billion increase in ERDF, CF, ESF and YEI payments.

The programme implementation is progressing. In close dialogue with the Member States, the Commission is closely monitoring the programmes at risk of delays.

The Commission provides substantial technical support and advisory services to Member States, e.g. Transnational Networks of SCO Practitioners, REGIO Communities of Practitioners and Peer 2 Peer exchanges, JASPERS, the European Broadband Competence Offices Network and Support Facility, FI-compass etc.

Furthermore, the legislative proposal for Cohesion’s Actions for Refugees in Europe (CARE) put forward further extraordinary measures, e.g. possibility of special cross-financing between the ERDF and the ESF, an optional temporary 100% EU co-financing rate for the accounting year 2021-2022, an increased pre-financing related to REACT-EU 2021 tranche, and off-the-shelf simplified cost options.

The Commission set up in March 2022 a special website addressing Ukrainian refugee crisis, where the programme authorities have access to all the interpretation replies on the use of all available EU resources can be found.
Finally, the Commission points out that the situation presented includes the additional allocation for the EAFRD from the MFF 2021-2027. Had this not been the case, the real situation for each Member State would have been different.

2.62 In terms of reporting, the Commission focuses on the recovery from the COVID-19 pandemic and fulfil its reporting obligations, in particular, for NGEU. The Commission does not intend to prepare further reporting on the immediate response beyond the already existing reports of the various instruments.

Recommendations

Recommendation 2.1 – Outstanding commitments

The Commission accepts the recommendation.

The Commission already monitors the implementation of the budget and the evolution of the overall level of outstanding commitments (RAL), as well as the related underlying factors. It regularly informs the Council and the European Parliament of the forecast needs and potential risks for the future. This information is included notably in the annual report on the long-term forecast on the future inflows and outflows of the EU budget 2021-2027, which is part of the Integrated Financial and Accountability Reporting (IFAR) under Article 247 of the Financial Regulation.

The Commission will keep on proposing adequate levels of payment appropriations in the framework of the annual budgetary procedures in order to meet the payment needs, also in light of the implementing rules for specific programmes and funds, as adopted by the co-legislators. The Commission recalls that the adoption of the budget lies ultimately within the remit of the budgetary authority.

Recommendation 2.2 – Sustainability of the EU budget’s exposure

The Commission accepts the recommendation.

The Commission monitors risks related to contingent liabilities on a continuous basis and periodically discusses them (usually every two months) in the Steering Committee for Contingent Liabilities, if need be. Risks related to contingent liabilities are reported on an annual basis in the 41.5 reporting, as required by the Financial Reporting.
INTRODUCTION TO THE COMMISSION REPLIES

The Commission welcomes that the European Court of Auditors (ECA) considers revenue continues to be free of material error and that revenue-related systems examined were generally effective.

The Commission will follow up on the issues identified by the ECA. As regards traditional own resources (TOR) and value added tax-based (VAT) own resources, the Commission will continue to intensify the follow-up on longstanding open TOR points and lifting VAT reservations where possible. It will follow-up on the TOR accounting weaknesses identified by ECA’s audits in Ireland, Sweden and Italy. The TOR accounting discrepancies in Italy might be considered under the infringement proceedings if no solution is found within deadlines set. Non-recovered amounts in the B account will continue to be closely monitored in all Member States, including through targeted desk reviews on TOR accounting in addition to the normal inspection programme.

For VAT the Commission will start reviewing its operational procedures mid-2023 taking benefit of the expertise gained from the functioning of the recently simplified VAT-based own resource. In the meantime, the Commission will continue to examine reservations in the context of the inspection activity and use the available tools to set deadlines to national authorities, where appropriate.

As regards GNI own resources (GNI OR), the Commission will continue to cooperate with the Member States to improve further the timeliness of the GNI OR verification process with a view to closing the current verification cycle by the end of 2024. Eurostat has put in place a system for monitoring the Member States’ compliance with the legal requirements and informs the stakeholders on the status of the GNI reservations in a transparent manner.

REGULARITY OF TRANSACTIONS

3.8 The Commission applied the methodology for budgeting the UK correction updates for the years 2017 to 2019 which takes into account the legal and budgetary implications of the UK withdrawal from the EU (Brexit). From 2021, the updates of the UK correction are not anymore part of the own resources system. Therefore, the financing methodology of the UK correction which existed until 2021 was not implemented anymore.

After Brexit, the UK correction updates are part of the financial settlement under the EU-UK Withdrawal Agreement. The corresponding amounts of UK contributions enter the EU budget as “other revenue” and not as own resources. This treatment of the UK post-Brexit contributions to the EU budget in fact maintains the uniform treatment of “other revenue” and the integrity of the own resources system.
EXAMINATION OF ELEMENTS OF INTERNAL CONTROL SYSTEMS

Member States’ accounting and management of TOR

3.10 - 3.11 and Box 3.1

As regards the weaknesses identified in Italy, an IT project is under development to solve the inconsistencies in the TOR accounting by end June 2022. By letter of 29/4/2022, the Italian authorities informed the Commission services that the first phase of implementation of the new system is ongoing. Progress in implementing the Italian action plan is closely followed-up by the Commission. The issue will be considered under the infringement proceedings as laid down in Article 258 TFEU in case of persisting inconsistencies between the statement of duties collected and the statement of duties established but not yet collected (so-called A&B account statements) after the deadline of end-June 2022.

3.12 The Commission will follow up on the problems identified by the ECA’s audits in Ireland, Sweden and Italy as regards the way national customs authorities manage customs duties not yet collected. It will do so in its usual follow-up to the ECA’s preliminary findings and these Member States will be required to take appropriate measures to address and resolve the shortcomings identified.

More generally, the Commission recalls that in an account of this type (recovery of outstanding customs debts or the B account) there is by nature a high risk of shortcomings and complexity involved. The Commission will continue examining the B account in its TOR inspections. In addition, a pilot project is launched for a desk review in 2022 on open B account cases on top of the normal Commission on-the-spot inspections. The desk review covers all 27 Member States.

TOR risk management and reduction of the customs gap

3.13 In general, the Covid-19 pandemic forced customs to change priorities and postpone certain activities in order to focus on the reaction to the pandemic and implement the necessary measures to facilitate trade in particular for personal protective equipment.

Following the recommendations in the landmark report of the Wise Persons Group presented on 31 March 2022, the European Commission is now preparing a customs reform package, including a legislative proposal to revise the Union Customs Code by the end of the year. Hence, a number of actions in the Customs Action Plan have been delayed awaiting the possible new orientations of the package. For the same reason the impact assessment under action 17 is expected to be completed one year earlier (end of 2022 instead of 2023).

As regards the revision of the Customs Risk Management Strategy, the Commission has worked on the preparation of a new strategy and accompanying action plan, by identifying the possible actions to be included.

The new customs risk management strategy will however need to take into account the possible new orientations and measures included in the new Customs legislative package tabled by the end of 2022.

3.14 A team of Union Representatives in Northern Ireland (NI) ensures close supervision and monitoring of the correct implementation, compliance with and enforcement of EU rules by the UK
authorities in respect of NI. However, the UK is not providing real-time access to IT systems containing relevant customs data in accordance with Joint Committee Decision No 6/2020. Only limited information is provided to the Union representatives a posteriori on a weekly and monthly basis which restricts their rights.

**VAT reservations and TOR open points**

**3.15** As the ECA correctly highlighted, the number of TOR points open at 31 December 2021 decreased whilst the long-outstanding points remained stable. The Commission wishes to point out the evident reduction of the long-outstanding open points older than 2014 over the three-year period 2019-2021 (decrease from 34% to 19%). The progress made by the Commission to close long outstanding points is confirmed by a decrease of such points by 47% (from 122 open points at the end of 2019 to 58 at the end of 2021).

With regard to VAT, the Commission acknowledges ECA’s finding that the lifting of VAT reservations had improved and wish to stress that one fifth of all reservations were lifted in one single year which is considered a very good result, also as lifting reservations depends on the cooperation from Member States.

**3.16** The Regulation does not confer any legal powers to the Commission inspectors to set formal deadlines during an inspection. The legislation provides the Commission with only two tools alluded to in Article 9(1), second paragraph of Council Regulation 1553/89. Those are setting a deadline with interest for late payment after that deadline or to launch an infringement procedure. However, those tools can only be used once any agreement with Member State cannot be reached.

In the meantime, the Commission will continue to examine reservations in the context of the inspection activity and use the available tools to set deadlines to national authorities, where appropriate.

**3.17** The Commission successfully continues to intensify the follow-up of open TOR points with priority of longstanding points with a potential financial impact. However, it should be stressed that accelerating the closing of open points also depends on Member States’ cooperation. In addition to the updated internal procedures, in 2022, the Commission has formalised its internal deadlines for its follow-up actions to Member States replies.

Also, the legal provisions enshrined in the new Making Available Regulation on the review procedure to be conducted within strict and legal deadlines and the yearly high level meeting between the Commission services and the Member States on persisting disagreements will eventually shorten the time length of written exchanges between Member States and the Commission and contribute to the acceleration and prioritisation of closing longstanding open points with high financial impact.

See also Commission reply to paragraph 3.27.

**Commission’s work on GNI**

**3.18** Following the actions taken by the Commission (Eurostat) to remind the Member States about their responsibility to provide the updated GNI Inventories and Process Tables, all remaining but one Member State provided these documents before end April 2022. The Commission is in the

---

1 COUNCIL REGULATION (EU, Euratom) 2022/615 of 5 April 2022 amending Regulation (EU, Euratom) No 609/2014
process of lifting the respective general GNI reservations. Eurostat remains in contact with Malta concerning the submission of their GNI Inventory and the Process Tables.

3.19 The Commission attaches great importance to the close monitoring of the timeliness of submission of the work on GNI reservations by the Member States. Eurostat has put in place a system of monitoring of Member States’ compliance with the legal requirements (including sending reminders where appropriate) and informs the stakeholders on the state of play on reservations in a transparent manner.

The availability of necessary guidelines for two GNI transversal reservations was impacted by the complexity of the issues and the extensive coordination across different statistical areas.

ANNUAL ACTIVITY REPORTS

3.22 In the specific case of the control strategy for customs value, most Member States have implemented significant improvements to their systems and procedures since the targeted first TOR inspection took place. This is also reflected in the written exchanges between the Commission and Member States within the formal follow-up to the reports and by a significant decline of total estimated TOR losses due to undervaluation.

The open points mainly relate to the financial follow-up of the TOR losses occurred in the past rather than to persisting shortcomings in the control strategy on customs valuation.

Finally, it has to be highlighted that the requests made by the Commission to Member States are not always immediately applicable (IT constraints, change in the legislation and/or procedures), hence the amendments triggered by the inspection reports need a reasonable length of time to be implemented.

3.23 As regards the UK undervaluation judgement, the CJEU confirmed the systematic shortcomings in the UK for the entire period of the infringement and the UK’s liability for the TOR losses incurred. The CJEU further endorsed a consistent application of the statistical method for the entire period of the infringement (like the Commission did), but requested that some additional considerations are taken into account.

Given the unprecedented nature of the quantification of TOR losses and the fact that the Court judgment did not provide any clear indication on the actual amount of TOR lost, a recalculation by the Commission might likewise be challenged by the UK and/or Member States, potentially at the CJEU. Therefore, a final quantification is likely to take considerable time.

CONCLUSION AND RECOMMENDATIONS

Conclusions

3.24 The Commission will follow up on the issues identified by the ECA’s audits in Ireland, Sweden and Italy in its usual follow-up to the ECA’s findings and these Member States will be required to take appropriate measures to address and resolve the shortcomings identified. Particular attention will be given to the implementation of the Italian action plan to solve the inconsistencies between the TOR accounts.
The Commission will continue to intensify the follow-up of open TOR points with priority of longstanding points with a potential financial impact.

For VAT, the Commission will review the operational procedures based on the new simplified and amended Council Regulation 1553/89. The review would commence second half of 2023, once operational experience has accumulated from the new simplified VAT-based own resource and within the applicable new legal framework. In the meantime, the Commission will continue to examine reservations in the context of the inspection activity and use the available tools to set deadlines to national authorities, where appropriate.

3.25 While the overall objective of the Customs Action Plan is not to reduce the customs gap, several actions in the Action Plan, mainly linked to risk management (Actions 1 JAC and 2 New customs risk management strategy) and to e-commerce (Actions 3 and 4), do have the ambition to significantly contribute to this objective. See also Commission reply to paragraph 3.13 regarding progress on the implementation of Action 2.

Follow-up of recommendations made in the Annual Reports 2018 and 2019

3.26 The Commission welcomes the ECA’s assessment on the positive evolution and enhancement of its monitoring on the TOR account statements and that the 2018 annual report recommendation 4.2. is considered fully implemented.

The highly risk-driven approach of selecting inspection topics and countries based on real data analysis implements the ECA’s 2018 annual report recommendation 4.1.

With a view to fully implement the ECA’s recommendation, the Commission has focused its inspection activities in 2020 and in 2021 (27 Member States and UK) on the reliability of the TOR accounts and related statements. On top of this and on the Commission’s own initiative targeted desk reviews on TOR accounting are taking place in 2022 for all Member States in addition to the normal inspection programme. Finally, all TOR statements are checked on a monthly or quarterly basis to identify potential unusual patterns and Member States are immediately contacted to provide the necessary explanations.

3.27 Regarding recommendation 1 of the 2019 Annual Report, in relation to the definition of risky operators, the ‘Joint Analytics Capabilities’ has worked with the information available in ‘Surveillance III’ database. On top of the definition of algorithms and the review of data availability, the cleaning of data is ongoing in parallel with work on the IT infrastructure.

Regarding recommendation 2 of the 2019 Annual Report, see Commission reply to paragraph 3.17.

Recommendation 1 – Take action to ensure reliability of the Italian TOR statements

The Commission accepts this recommendation and will consider the Italian TOR accounting discrepancies under the infringement proceedings if the issue remains unsolved within the deadline set by Italy and ECA.

Recommendation 2 – Improve management of VAT reservations

The Commission accepts this recommendation.

The Commission plans to review its operational procedures in due time. However, a radical simplification of Council Regulation 1553/89 entered into force starting with the financial year
2021 only. VAT statements under the amended Regulation will be submitted for the first time by 31 July 2022. That review is planned to be initiated once operational experience has been accumulated working with the new and simplified statements and the new legal framework.

In the meantime, the Commission will continue to examine reservations in the context of the inspection activity and use the available tools to set deadlines to national authorities, where appropriate.

**Recommendation 3 – Improve the assessment of financial risks in the area of customs**

The Commission accepts this recommendation.
REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS’ 2021 ANNUAL REPORT

“CHAPTER 4 – SINGLE MARKET, INNOVATION AND DIGITAL”

INTRODUCTION TO THE COMMISSION REPLIES

In Horizon Europe, the biggest research and innovation programme, with a budget of EUR 95.5 billion, the Commission capitalises on the experience gained under Horizon 2020 (H2020) and continues to apply its simplification policy. Horizon Europe uses a standard Model Grant Agreement (MGA) for all EU funding programmes, makes extensive use of simplified costs options (unit cost, flat rate and lump sums), employs simpler cost reimbursement schemes in appropriate areas and implements a streamlined audit system.

REGULARITY OF TRANSACTIONS

4.6 The Commission takes note of the level of error calculated by the ECA and will follow up on the issues identified.

The Commission further refers to its own estimate of the level of error for the MFF heading, as disclosed in the Annual Management and Performance Report (please see also reply to § 4.29).

For Research and Innovation expenditure, the error rate is calculated on the basis of the audits performed during a multiannual financial period, i.e. of 418 statistically representative audited cost claims covering cost statements since the beginning of the H2020 framework programme and 170 audits performed under Connecting Europe Facility (CEF). In other words, the Commission opts to implement multiannual control strategies, setting cumulative error rates for the entire duration of the programme. In the case of H2020, the Commission adjusted the originally estimated residual error based on 1 304 audited participations closed in 2020 and 2021.

As regards data in figure 4.3., which presents a breakdown of the error rate by type of errors, the Commission does not consider the clearing of prefinancing to the European Union Agency for the Cooperation of Energy Regulators (ACER) to be affected by a non-compliance with public procurement rules.

See also Commission reply to paragraph 4.9 a).

4.7 Research & Innovation framework programmes have become much simpler over the past 10 years. Funding based on actual costs, however, remains relatively complex and error prone as it needs to accommodate a large variety of claims and accounting practices.

Therefore, two important measures for further simplification in Horizon Europe are, an increased use of lump sums (following a successful pilot under H2020) and a unit cost system for personnel costs available in any grant.

Lump-sum funding is being rolled out gradually, with a first significant wave expected in the 2023-2024 work-programme. The unit cost system for personnel costs (currently under development)
has enormous potential since personnel costs represent more than 60% of the budget of an average grant, and is by far the biggest source of errors.

In parallel, the Commission is providing support to Horizon Europe applicants through communication campaigns and workshops, targeting the more ‘error-prone’ beneficiaries such as small and medium-sized enterprises and newcomers.

4.8 The Commission is working on simplification on a continuous basis. However, despite Commission actions centred on systematic, widespread and targeted communication campaigns, there remain certain types of beneficiaries such as small and medium-sized enterprises and newcomers, which are more error prone. Nevertheless, the participation of these beneficiaries is significant for the success of the framework programme.

The Commission takes note that the share of H2020 and FP7 in the overall error rate is lower than last year.

4.9 a) As regards the two cases of irregularity in procurement procedures referred to by the ECA, the Commission underlines the following:

The case under CEF is related to a situation where a national court had declared a procurement procedure illegal while not voiding the contract. As contract remained in effect and as the works were effectively delivered, the Commission had to consider the costs eligible and make the corresponding payments.

As regards the second case, the Commission takes note of the procurement error found at the European Union Agency for the Cooperation of Energy Regulators (ACER) in 2020, but does not consider that the audited Commission’s payment in 2021, for clearing the prefinancing of the EU contribution to ACER, is affected by this error. The error mentioned by the ECA occurred at the level of the Agency in relation to a procurement procedure for which the authorising officer of the Agency is responsible. The Commission recalls that it pays a balancing contribution to the Agency, based on its outturn account. The Commission had no other option but to clear the pre-financing related to the EU contribution as all legal conditions to make the clearing were met.

4.10-4.11 The Commission takes note of the cases of quantifiable errors made by the beneficiaries and of which the Commission services were not aware as the auditors contracted by beneficiaries (CFS auditors) did not detect them within the scope of their mandate.

The certificates on the financial statements (CFS), issued by the CFS auditors, cover the total amount of the grant claimed by a participant and they certify ex-ante the eligibility of cost claims to be subsequently reimbursed by the Commission.

Acknowledging the shortcomings and to further improve the quality and reliability of the CFSs, the Commission organises targeted webinars addressed to the CFS auditors, to raise awareness of the most common errors during audits (e.g., personnel costs, subcontracting and other direct costs, etc.)

In addition to the self-explanatory template for H2020 audit certificates, the Commission provides feedback to the CFS auditors when errors in the CFS are identified via ex-post financial audits.

Lastly, the Research Enquiry Service provides guidance to the CFS auditors through online requests.
Ineligible personnel costs

4.12 Horizon 2020 was a step forward in the simplification and harmonisation of the rules for reimbursement of costs incurred. Nevertheless, personnel costs have remained the main source of errors. This seems to be, at least partially, a logical consequence of the fact that personnel costs account for the largest share of the total cost declared by H2020 beneficiaries.

Acknowledging this shortcoming and for the current MFF (2021-2027), which includes the Horizon Europe programme, the Commission has established a corporate Model Grant Agreement that foresees a simple method for charging personnel costs, based on a daily rate calculation, replacing the error-prone method used in H2020.

Moreover, and in agreement with the findings of the ECA report for the year 2020, the Commission has intensified the frequency of its trainings and outreach activities (see also replies to point 4.11, 4.20 and recommendation 4.1).

In 2021, the Commission organised 7 webinars on how to ‘avoid errors in declaring personnel costs in H2020 grants. SMEs and newcomers in grants approaching their respective reporting periods were specifically invited. During these events (which continue to take place on a bi-monthly basis in 2022), the Commission is encouraging the use of the personnel cost wizard.

Additionally, the Commission has organised a webinar addressed to Project Officers and Financial Officers in which Commission services and the ECA made presentations, raising awareness on the importance of reducing the error rate in H2020. This event included an exhaustive presentation of the available tools (IT tools, guidance, trainings, webinars) to perform ex-ante controls.

Calculation of the hourly rates

4.13 The calculation of hourly rates remains the focus of outreach activities organised on a regular basis by the Commission (see reply to 4.12)

Extensive use of the Personnel Cost Wizard would help beneficiaries correctly declare their personnel costs. Moreover, beneficiaries are encouraged to make use of the Research Enquiry Service to directly request clarifications on practical matters related to grant management.

4.15 The calculation method for the yearly hourly rates in H2020 is based on the last closed financial year which takes into account statutory holidays and the thirteenth monthly salary. The Commission deemed this as a reliable numerator. Indeed, for periods not covering a full financial year, differences in the hourly rate of the same person may occur, but the beneficiaries can opt for a simplified common number of productive hours which prevents the risk of discrepancies.

This calculation method has been changed and simplified for Horizon Europe, where a single rate will be calculated per reporting period.

4.16 The Annotated Model Grant Agreement caters for practical examples on bonuses and calculation of productive hours. As for the latter, beneficiaries have the option to apply a standard number of productive hours, thus reducing the risk of errors. This option is encouraged by the Commission throughout the implementation of the programme.

Time reporting

4.17 The Commission has also simplified Horizon Europe’s formal requirements related to the time recording for personnel costs related to the project. Deficiencies in time recording for project
staff, however, may still potentially occur in grants as made evident in the examples reported by the ECA.

To address the incorrect time recording, the Commission made available different guidance documents to the participants, focusing on the mandatory nature of recording hours devoted to the execution of the action. The introduction of a declaration for persons working exclusively for the action intended to simplify the procedures. The auditors contracted by the beneficiaries are also instructed to verify the existence of proper record-keeping systems when providing the Certificate on Financial Statement.

Adjustments to previous reporting periods and other errors in personnel costs

4.18 The Commission acknowledges the difficulties that the hourly rate calculation method may present, especially for newcomers to the programme. However, no adjustment to financial statements should occur without proper reason and justification.

4.19 The Commission has included, in its guidance on H2020 ex-ante controls for interim and final payments, specific risk fiches dedicated to the risks mentioned by ECA (Use of budgeted instead of actual costs, wrongly calculated hourly rate, no proper time registration, unplanned subcontracting costs).

Training of principal actors involved in the deployment of ex-ante controls is already taking place.

For what concerns the specific case related to the eligibility of an experienced researcher to be awarded an MSCA grant, the Commission notes the peculiarity of the isolated case described, which should not be taken as an example of a common error.

Box 4.2 - Example of an ineligible experienced researcher benefitting from a Marie Skłodowska-Curie Individual Fellowships (IF) action

In the context of the Commission follow up to the ECA’s finding in box 4.2, the beneficiary claims that the researcher had gained additional unpaid full-time research experience before the start of her doctoral studies.

Full-time equivalent research experience is measured from the date when a researcher obtained the degree which would formally entitle him or her to embark on a doctorate.

Thus, the total research experience prior to the call for proposals deadline is longer than four years and may be in conformity with the second eligibility condition defined in the Work Programme.

While these additional details were not provided at the time of the application, the Commission must examine them as they can have a material impact on the eligibility and recoverability of the grant.

The Commission is analysing the additional evidence provided by the beneficiary to support their claim.

Issues in private entities, in particular SMEs and new entrants

4.20-4.21 The Commission shares the view of the ECA (corroborated by statistical evidence) that SMEs (and newcomers) are the most error-prone beneficiaries. However, their participation, vital to the success of the programme, is encouraged at all levels by the Commission.
To mitigate the issue, the Commission targets mainly newcomers and SMEs individually inviting them to participate in its online information campaigns on avoiding errors when declaring costs in H2020 (see also reply to point 4.12).

**Errors in other direct costs**

**4.22** The Commission acknowledges the occurrence of errors related to depreciation and has already included in its ex-ante control guidance a reinforced control specific to the risk-type ‘equipment costs not declared as depreciation costs’.

**Box 4.3 - Works costs claimed and reimbursed twice**

The Commission acknowledges the occurrence of one case of double reimbursement and confirms that a corrective action has already been taken: on 25 May 2022, the Commission issued a pre-information letter to the concerned beneficiary in view of recovering the unduly claimed amount, which will be recovered in the coming weeks.

**REVIEW OF IT SYSTEMS FOR RESEARCH GRANTS**

**4.23** The e-Grants suite is a key IT tool for the management of the research and innovation framework programmes’ grants. It covers the whole cycle of the grants and plays a key role in the operational and financial monitoring of H2020 and of its successor, Horizon Europe.

**4.24** e-Grants suite is also a key tool for the monitoring of the projects and it is linked to ABAC, the Commission IT tool for accounting, which ensures the consistency of the financial information.

**4.25** The Personnel Costs Wizard is indeed systematically promoted in all activities related to H2020. Yet, participants in on-going grants, and in particular recurrent beneficiaries, do not use it very often. At this stage of the programme, it is unlikely that the Commission will be able to significantly increase the percentage of users.

**4.26** The Commission has automated H2020 grant management, and this digitalisation will further continue under Horizon Europe.

In relation to ex-post audits, the Commission IT systems keep records of all documents collected during the audits. These systems also include the necessary financial data from auditees’ accounting systems related to the audited projects. Hence, accounting and invoice-level details are made available for ex-post financial audits.

Linking accounting systems of H2020 beneficiaries to SYGMA reporting would not be technically feasible. Besides, as beneficiaries are autonomous entities not under the control of the Commission, such an automatic retrieval of documents would raise legal issues. Ex-post audits are planned to guarantee an appropriate coverage of samples.
ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

4.28 The Commission welcomes the observation from the ECA that the Annual Activity Reports examined provide a fair assessment of the respective DGs’/Executive Agency’s financial management in relation to the regularity of underlying transactions.

4.29 The Annual Activity Report (AAR) of DG RTD states risk-at-payment of 2.29 % for all the Research and Innovation family and a residual error rate of 1.67 % for DG RTD.

These error rates are calculated on the basis of the results of 1304 participations audited by the Commission on H2020, available when drafting the Annual Activity Report. Based on this, the Commission is confident with the result of the error rate it has calculated in accordance with its methodology.

The Commission addressed the observations reported by the ECA on the calculation of the error rate and welcomes the ECA’s acknowledgement.

4.30 The Commission’s risk-at-payment for H2020 falls within the range established in the Financial Statement accompanying the H2020 Regulation (error rate within a range of 2-5%, with a residual error rate as close to 2% as possible). Therefore, in this context, a reservation is not necessary for H2020 expenditure.

4.31 The ex-post audit strategy related to Horizon Europe will be deployed in the coming years, aiming at a residual error rate below 2%.

4.32 The Commission is committed to fully implementing the recommendations of the Internal Audit Service in a timely manner. Nonetheless, as the ECA states one “Very Important” IAS recommendation was overdue due to the delay in the signature of the new framework contract with the external auditors’ firms (signed in early 2022).

Concerning the external audit firms contracted by the Common Audit Service (CAS), one should note that the new, signed framework contract introduced stricter quality requirements such as compulsory training, not an obligation previously.

CONCLUSION AND RECOMMENDATIONS

Conclusions

4.37-4.38 The estimated error rate reported by the ECA, calculated on annual basis, is one indicator of the effectiveness of the implementation of EU expenditure.

At the same time, the Commission implements a multiannual ex-post audit control strategy for research expenditure. On this basis, its services estimate a residual error rate, which takes account of recoveries, corrections and the effects of all their controls and audits over the period of implementation of the programme.

Based on the work carried-out, the Commission considers that the risk-at-payment presented in the AMPR for MFF1 is representative of the level of error (see points 4.6 and 4.29). This estimate is
based on a methodology which allows the Commission, as a manager of the EU budget, to identify and distinguish between high, medium and low risk areas and therefore focus the Commission’s efforts to mitigate the risk.

In the case of H2020 the risk-at-payment (2.29%) remains within the range stated in the legislative financial statement accompanying the Commission’s proposal for the H2020.

For Horizon Europe, the increasing use of lump sums and the on-going development of an optional unit cost (a single daily rate per beneficiary), replacing all the calculations for personnel costs, will contribute to reducing the risk of errors.

Follow-up of recommendations made in the Annual Reports 2019-2020

4.39 The Commission considers that all recommendations from previous ECA annual reports have been fully implemented even though the measures taken will need some time to materialize.

Recommendations

Recommendation 4.1 – Use of the Personnel Costs Wizard

The Commission accepts this recommendation which is currently being implemented.

The Commission continuously encourages the use of the Personnel Costs Wizard through various actions. A detailed user guide at the Funding and Tender Portal in section H2020 online manual/Grants/Grant Management/periodic reports.

The wizard is available to beneficiaries at the moment of the encoding of costs in their financial statements. The use of the wizard is promoted in all webinars on “avoiding errors in declaring personnel costs in H2020” in 2021 (reaching a total of 98 783 views) as well as in trainings and meetings with National Contact Points (NCPs).

The Commission is working on the adaptation of Personnel Costs Wizard to Horizon Europe.

Recommendation 4.2 – Guidance to beneficiaries

The Commission accepts this recommendation. Ensuring a clear understanding of the Horizon Europe rules, in particular the ones on cost eligibility, is of the utmost importance.

The Commission has already started its implementation through:

- Outreach and communication events have already been taking place since the beginning of the Horizon Europe programme, focusing on the key differences between H2020 and Horizon Europe, particularly those regarding cost eligibility aspects. It should be noted that two coordinators’ days already organised, have reached more than 170 000 views.

- The Research Enquiry Service, a dedicated helpdesk providing clarifications and explanations on EU Research programmes (including H2020 and Horizon Europe) already in place.

Recommendation 4.3 – Improvements in the ex-ante controls

The Commission accepts this recommendation which is being implemented.
The current Guidance for H2020 Ex-ante controls on interim and final payments available in GoFund already includes dedicated thematic ‘forms’ addressing specific risk types.

One of these forms covers the risk of ‘wrongly calculated hourly rate (use of estimates, wrong calculation of productive hours, bonuses wrongly included in the hourly rate, etc.)’.

This recommendation will be shared with the members of the Research and Innovation Network for ex-ante practitioners (RINEC, a group created in 2021 and aiming at sharing best practices and streamlining ex-ante controls), stressing once more the importance of the issue.

The Commission will also assess the feasibility of adding a disclaimer appearing at the moment of filling-in the beneficiaries’ financial statements, reminding them that recalculation of hourly rates is not allowed.

**Recommendation 4.4 - Guidance addressed to the independent auditors**

The Commission accepts the recommendation which is being implemented.

The Commission has further improved the guidance for CFS auditors by making available on the Funding & Tenders Portal/YouTube a series of webinars tackling most common errors discovered during audits as well as the most error-prone cost categories.

The Commission will further continue raising awareness among CFS auditors.

**Recommendation 4.5 - Functionalities in eGrants**

The Commission accepts this recommendation.

The Commission will continue to strive towards further digitalisation as enabler to simplification. Therefore, it would be fair to expect a future enhancement of its digital tools. For the next research and innovation framework programme, the Commission will assess the feasibility of extending functionalities in e-Grants for risk assessment and automatic checks, in line with its simplification policy.
INTRODUCTION TO THE COMMISSION REPLIES

Cohesion policy under shared management is implemented by the Member States through a diversity of programmes (415) and actors at national, regional or local level, leading to a multilayer assurance framework. Managing authorities select operations and carry out management verifications on declared expenditure, the first line of defence to prevent and detect irregularities. Audit authorities are the second level control layer and confirm based on system audits and audits of representative samples of operations whether management verifications were effective to prevent irregularities. The Commission bases its assurance process on all audit results summarised in assurance packages that contain audit opinions and reported error rates for each programme, as well as on its further audit work to assess the effectiveness of the programme authorities’ work and reliability of reported audit opinions and error rates.

Against this diversified reality, the Commission provides in full transparency, in the respective annual activity reports (AARs) of DG REGIO and DG EMPL:

- A detailed assessment of the situation of each programme, e.g. the effectiveness of the functioning of management and control systems and error rates, based on all available audit results (see graphs on pages 39 and 59 of the 2021 AARs of DG REGIO and DG EMPL, respectively);

- For each programme confirmed error rates for the previous accounting year and most recent error rates reported, before and after additional corrections by programme authorities as a result of audits, as well as the Commission audit opinion (see tables in annex 7B of each AAR).

Overall, since the start of the multiannual period, the Commission concluded that an increased number of programmes function well or sufficiently well. This may be attributable to the continued efforts invested into administrative capacity building, training, remedial actions taken as a result of audits and the sharing of good practices and tools. Programme specific error rates are aggregated in a Key Performance Indicator on legality and regularity (KPI 4 for DG EMPL and KPI 5 for DG REGIO), presented as a range between the weighted average confirmed error rate for all programmes complemented with a maximum value to take account of possible additional risks (1.9% to 2.5% for DG REGIO, 1.7% to 2.4% for DG EMPL).

The Commission also presents in the AARs important corrections implemented by Member States (above EUR 1.6 billion of definitive corrections in total for all 2020–2021 accounts received), including additional financial corrections requested by the Commission to follow up on its own audits, ECA audits or OLAF reports to bring the residual risk below 2% for past programmes, where necessary (in total in 2021 at least EUR 193 mn) – see Annex 7H of the AARs of DG REGIO and DG EMPL.

In 2021 the Commission requested audit authorities to pay particular attention to new eligibility conditions and flexibilities introduced with the CRII/CRII+ amendments to address the COVID-19 crisis, as well as to the potential unjustified use of emergency procedures in public procurement. It also continued to actively promote the use of simplified cost options (SCOs) and financing not linked to costs (FNLTC) for the 2021–2027 period, as these schemes are expected to be less error-prone.
Results of testing of transactions and review/re-performance of audit work

5.15 The level of error estimated by the ECA has remained stable in comparison with those of previous years. The Commission will follow up all errors found by the ECA and request additional financial corrections, where appropriate and legally possible. The Commission also notes that more than one-third of the ECA’s error rate estimate refers to just one national programme and reflects a very specific issue.

The estimates of the level of error disclosed in the 2021 AARs of DG REGIO and DG EMPL result from a detailed analysis of the situation of each programme.

The Commission notes that the maximum value of its error estimate for Cohesion policy (2.5%) that is considered in the AMPR for the calculation of the Commission’s overall risk at payment falls within the ECA’s error range estimate for the third year in a row.

The Commission considers that in the case of two transactions identified by the ECA in relation to one 2007-2013 programme, there is no legal basis for imposing financial corrections.

5.16 Audit authorities play an important role in detecting errors which led to significant financial corrections and withdrawals before the programme accounts were submitted to the Commission. As reported in DG REGIO and DG EMPL 2021 AARs, Member States deducted cumulatively since the beginning of the 2014-2020 period respectively EUR 12.2 billion for ERDF/CF expenditure and EUR 3.7 billion for ESDF/YEI expenditure of definitive corrections and temporary withdrawals in the accounts, of which 15% to 20% as a result of the audit authorities’ work.

Audit authorities reported a total error rate above 2% for around one third of programmes, thus demonstrating their detection capacity.

The Commission agrees that some errors remained undetected or were inappropriately considered in the calculation of the reported error rate, in individual cases.

5.17 Based on a common typology, the Commission and the audit authorities identified generally the same categories of irregularities as the ECA: ineligible expenditure, public procurement, audit trail and State Aid. The Commission will follow up all errors reported by the ECA and will apply financial corrections where appropriate and legally possible.

The Commission considers that in the case of two transactions identified by the ECA in relation to one 2007-2013 programme, there is no legal basis for imposing financial corrections.

Ineligible costs

5.18 - 5.19 Management verifications are the first line of defence for the prevention and detection of errors, in particular when it comes to eligible costs and rules.

The Commission addressed updated guidance to Member States for the 2014-2020 programming period, which, combined with the enhanced use of simplified costs options, aimed at improving further the efficiency of management verifications to detect ineligible costs and operations.
Efficiency of verifications depends however on the number of staff available in the concerned administrations for such verifications, the level of training they received and their related experience.

The Commission is taking preventive and corrective action and requests remedial measures as soon as deficiencies are detected. This entails improvement of methodological tools, recruitment of additional staff including experts, training activities on newly developed tools or on the correct interpretation of most frequent errors, as well as improvement in selection procedures.

To make management verifications more efficient and targeted in the 2021-2027 programming period, management verifications become risk-based in order to better focus the administrative resources available to targeted sources of errors. This requires a continuous adjustment of risk management approaches by managing authorities, based on effective feedback mechanisms between programme authorities about all available control and audit results. In particular, the typology of audit findings reported year on year to managing authorities should allow them to integrate the more frequent sources of errors in their risk assessments and to adapt their management verifications approaches and tools accordingly.

**Box 5.1 - Costs declared for activities outside the eligibility area**

In the case of the Netherlands, the Member State explained that the Monitoring Committee agreed in a session in 2016 on the type of operation as the one under the ECA’s audit (beneficiary not located in the eligible area but activity benefitting directly the eligible area). This agreement, included in the minutes of the monitoring committee, was however not reflected in the subsequent table proposed for formal decision listing the accepted operations. This was clarified by the Monitoring Committee in 2022.

**5.22 Beneficiaries implementing operations in favour of participants not being in employment, education or training are expected to carry out proportionate checks of the self-declarations obtained from participants, in particular about their employment status, with all possible independent sources. However, beneficiaries, and also programme authorities, do not always have access to social security or employment data bases, thus limiting the possibility to carry out such verifications in practice.**

**Box 5.2 - No verification of participant status**

The NEET status of young participants should be checked on the basis of reliable and verified sources, as much as possible and feasible, taking into account the fact that Article 16 of the ESF Regulation does not set out a definition of a person not in employment, education or training. Therefore, it is for the Member States to decide when to check the eligibility of the participants, as well as whether the criteria are met.

In case of the French project (two transactions) mentioned at the end of Box 5.2, the beneficiary carried out checks on the status of participants in the employment service database. The eligibility of participants was verified but the audit trail of these checks was not completely documented.

The Commission is also aware of difficulties encountered by many other ESF/YEI implementing bodies or beneficiaries to access confidential data linked, for example, to the absence of employment of participants.

For this reason, the 2021-2027 CPR no longer refers to NEETs as an eligibility criterion, but as a target group, and therefore only refers to “youth”, without determining any rules on the definition of the target group that is left to the discretion of the Member States.
5.23 The Commission has actively worked since the introduction of the simplified cost options to progressively extend their use and considers that these efforts have already led to positive results and significant simplification and reduction of administrative burden.

As recommended by the ECA in past audits, the Commission will continue to actively promote the use of SCOs set out in the 2021-2027 Common Provisions Regulation, in order to reduce the administrative burden on the beneficiaries, promote result-orientation and further reduce the risk of error.

Box 5.3 - Methods used for reimbursing beneficiaries and declaring expenditure to the EU budget for SCOs not in line with regulatory requirements.

In the four cases reported by the ECA in the Irish programme, the programme authorities defined in different documents to beneficiaries that the ESF eligible costs would be based on SCOs (flat rates defined in Articles 68(b) and 68b(1) CPR), while also applying national reimbursement rules based on real costs. This dual system is not recommended by the Commission for reasons of simplification for beneficiaries. However, this does not run contrary to the CPR and did not put at risk the EU budget, since real costs exceeded the amounts declared using SCOs.

Ineligible projects

5.24 - 5.27 For two projects under the closure of a 2007-2013 programme the Commission considers that there is no legal breach for the reasons explained under Box 5.4.

For the reasons explained under Box 5.5, the Commission considers that projects under one Spanish YEI programme were eligible, but not all costs should have been reimbursed.

The Commission will consider with the Member State alternative ways to deliver the audited YEI scheme under the ESF for the upcoming programming period.

Box 5.4 - Projects previously supported through national funds and reassigned to receive EU support outside the eligibility period.

The two cases audited by ECA refer to the 2007 – 2013 programming period for which there is no provision on when operations can be selected. The only legal requirement was that under the provision of Article 56 Regulation 1083/2006 the relevant expenditure actually needed to be paid during the eligibility period, i.e. between 1.1. 2007 and 31. 12 2015, and that an operation implemented before 1.1. 2007 could not be selected for support. Both of these requirements were fulfilled in the two cases. Even if the operation was actually selected later, it does not affect the eligibility of the related expenditure that was incurred within the eligibility period.

The managing authority selected the projects and therefore they became part of the programme. The Commission therefore does not consider that there was any breach of the applicable legal provisions.

Further provisions prohibiting the selection of physically completed operations were introduced in the 2014 – 2020 CPR under Article 65 (6). However, no such provisions were in force for the 2017-2013 programming period. As per the recommendation of the ECA on retroactivity of operations.
under the 2014 – 2020 programming period in the 2019 Annual report, the Commission reminded Italy about the impossibility to select physically completed operations for that period.

**Box 5.5 - Retroactive registration of NEETs in the Youth Guarantee**

Most participants were eligible being unemployed the day before the start of the YEI action. With retroactive registration, young NEETs already benefitting from national employment measures were identified by the public employment service to be integrated under the YEI programme. The national legal framework allows such retroactive registration within a time limit, subject to other conditions. Subsequently, Spanish authorities informed the participants about their registration.

The Commission already applied a flat rate financial correction of 25% on the basis of its own checks and audits. It considers that this flat rate correction is sufficiently high to also cover the additional ECA findings.

**5.27** In relation to the minimum duration of individual temporary contracts, the national authorities opted for a minimum duration of 28 days based on an Employment Committee (EMCO) conclusion of December 2018, notwithstanding a Commission recommendation.

However, in practice for a significant number of the audited cases the total duration was more than 6 months. This was sometimes achieved through several consecutive contracts, possibly with different employers. The Commission considers that, across the board, the scheme was implemented effectively as it brought the participants closer to the labour market and thereby increased their chances of long-term employment as illustrated by the statistics provided by the Member State.

*Infringements of internal market rules*

**5.30 – 5.31** Over the past years, errors related to State aid account for smaller share of the errors identified by Member States authorities and the Commission.

For the most recent accounting year 2020 – 2021, according to the joint typology of errors agreed with audit authorities, only 1.7% of the findings identified by Member States, and 9% of those identified by the Commission, concerned State aid.

The Commission continues to implement the measures designed under its State aid action plan identifying and disseminating good practices and offering training to all ESI fund stakeholders.

**5.33 – 5.34** Public procurement, characterised by complex national and EU rules, remains an important source of error detected and reported by audit authorities. The Commission considers that audit authorities better detect such public procurement issues nowadays, a sign that the administrative capacity actions implemented under the Commission’s action plan on public procurement bear fruit. This is also reflected in the relatively limited number of public procurement errors reported by the ECA.

The Commission decision on financial corrections for public procurement errors updated in May 2019 also contributes to this better detection of errors by offering a harmonised approach to the Commission and Member States’ programme authorities when dealing with public procurement irregularities (Decision C (2019) 3452).
However, the Commission pursues actions under its public procurement action plan to ensure that beneficiaries (contracting authorities) and programme authorities continue to improve their procurement practices and increase their related administrative capacity.

**Box 5.7 - Weaknesses in the verification and implementation of contract terms**

As regards the advance purchase agreements (APAs) (see Box 5.7), the manufacturers demonstrated detailed breakdowns of production costs to the Joint Negotiation Team, comprising representatives from seven Member States, chosen from the members of the Steering Board, and Commission officials. This information was deemed sufficient given the fact that, at the time of the negotiations, a vaccine against COVID-19 did not yet exist. However, due to the commercial secrecy of the negotiations, no written records of these breakdowns were made.

All APAs include a provision that the Commission has the right to carry out on-the-spot checks and inspections until five years after the final payment. Each of the four APAs examined by the ECA led to the development of a vaccine that obtained a conditional marketing authorisation, and, in all but one case, the manufacturers delivered the quantities agreed in the APA. Thus, only in this one case of non-compliance, it was necessary to carry out in-depth checks: the evidence collected in 2021 could be used to the Commission’s and the Member States’ advantage in judicial interim measures proceedings against the manufacturer, which resulted in a positive outcome.

One APA provides for an upfront payment to the manufacturer to secure the ordered volume of vaccines doses combined with a full guarantee on the investment, i.e. a re-fund of 100% of the upfront payment – inter alia – in case of failure to obtain marketing authorisation and for contracted doses not delivered.

**Work of audit authorities**

**5.40 - 5.41** Under shared management, programme managing authorities control in first instance the expenditure declared by beneficiaries. This is the first line of defence in ensuring the legality and regularity of expenditures. Audit authorities perform second level audits to test the quality of management verifications.

The Commission has continued in 2021 to extensively cooperate with the programme audit authorities to ensure a consistent and robust assurance and control framework, including under conditions of practical restrictions for audits during the pandemic, and to improve the quality of the assurance work as needed, strengthening the necessary detection and corrective capacities.

As reported in DG REGIO’s and DG EMPL’s AARs, the Commission has in particular identified weaknesses and requested improvements for 15 ERDF and/or ESF/YEI audit authorities or bodies in charge of audits out of 116 audit authorities for Cohesion policy. These audit authorities are in charge of auditing 6.5% for ERDF/CF expenditure and 8.5% for ESF/YEI/FEAD expenditure respectively.

**5.41** At programme level, for the accounts accepted in 2021, the Commission confirmed respectively a residual total error rate below materiality for 243 ERDF/CF programmes (83%, including in some cases adjustments without a material impact) and for 167 ESF/YEI/FEAD programmes (78%, including in some cases after adjustments made without a material impact), and above materiality for 50 ERDF/CF programmes (17%) and for 48 ESF/YEI/FEAD programmes...
(22%). These programmes above the materiality threshold represent in 2021 only one fifth (20%) of the Cohesion programmes.

Moreover, as per the legal requirements, the two cases where audit authorities had included advances to financial instruments, were reported in the AARs for the purpose of the KPI on legality and regularity, but cannot lead to additional financial corrections.

5.42 For another assurance package with a RTER recalculated by ECA above 2%, there is no legal basis for additional corrections. The Commission therefore considers that the RTER remains below 2% in this case.

5.43 Over the past years the level of programmes for which the Commission has recalculated a RTER above the materiality threshold remains stable for ERDF/CF OPs (around 13%) and decreases for ESF/YEI/FEAD OPs from 40% in 2017 to 11% in 2021.

The Commission notes that the assurance packages for which the ECA recalculates a RTER above 2% concerned in some cases a limited increase of the RTER.

5.44 - 5.45 The Commission agrees that errors and irregularities should be detected and corrected by managing authorities in the first instance. For this reason, it continues to provide support to those authorities to improve their administrative capacities through guidance, targeted support, continuous training and professional development, as well as support to simplify procedures and to avoid gold-plating. When it is identified that managing authorities missed errors, the Commission requires targeted remedial actions to improve the concerned authorities’ quality and quantity of verifications carried out before declaring expenditure. In addition, the Commission also encourages audit authorities to report back and discuss with managing authorities the errors that they missed in order to improve their preventive and detective capacity, by putting in place further guidance or targeted trainings for the concerned desk officers.

The Commission considers that it has reasonable assurance on the work of most audit authorities, except for a limited number that require major improvements of their audit capacities to remedy the weaknesses found (see the common Commission reply to paragraphs 5.40 and 5.41 above).

Concrete improvements were achieved in the last years based on targeted remedial actions recommended in several cases where weaknesses had been identified, as illustrated in the respective AARs.

The Commission assesses the reliability of audit authorities not only on the basis of the recalculated error rates (which can be influenced by single errors having an important statistical impact) but on a number of criteria which, if not satisfactorily assessed, reflect the presence of systemic weaknesses in the work of audit authorities.

The Commission has established a robust continued cooperation with all audit authorities. This includes the sharing of common audit tools, such as detailed checklists, sharing of good practices between peers and a continuous professional development of the staff of audit authorities.

5.46 The Commission continuously and proactively promotes good communication between audit authorities and the programme managing authorities, as shown for example in the ‘Charter on good practices’ promoted by the Audit Community (Commission and Member State’s audit authorities) when carrying out audits under Cohesion policy. The Commission considers that such good communication and feedback exercise is key to ensure improvements of control systems and better targeted management verifications.
The Commission reported in the respective AARs of DG REGIO and DG EMPL limited use of the flexibility offered in sampling in response to the COVID-19 crisis by the audit authorities. Despite the health crisis, restrictions and increased workload on public administrations, audit authorities continued to use statistical methods for above 91% (REGIO 91%, EMPL 92%) of expenditure entered in the 2019/2020 accounts. These figures increased for the last accounts submitted by 1 March 2022, for which the audit authorities used statistical samples for above 94% (REGIO 94%, EMPL 96%) on average of the certified expenditure. This flexibility was temporary and ends after the 2019/2020 accounting year.

As indicated in its reply to paragraph 5.44, the Commission is continuously working with the audit authorities to improve the audit trail for their audit work, including for sampling when necessary.

The Commission will continue to promote the good practices reported in the “Reflection paper on audit documentation” elaborated jointly by a working group composed of audit authorities and Commission representatives, as reported in ECA’s 2019 annual report in Box 5.8. It will remind the concerned audit authorities to keep an adequate audit trail of the drawing of their samples.

The Commission recently reminded audit authorities that checklists used for the audit of operations should contain an indication of whether a fraud suspicion was identified as a follow-up to ECA’s recommendation N° 5.2 in the annual report 2020. It welcomes the fact that the situation improves, and will continue to remind audit authorities to fully document in their checklist the work which is done on the ground in the area of fraud detection.

The Commission’s assurance work and reporting of residual error rate in its annual activity reports

The Commission has designed its assurance system to allow the Directors-General to provide assurance on each of the 418 individual OPs, as per their obligation as authorising officers by delegation. The Commission considers it has reasonable assurance on the legality and regularity of the underlying expenditure, except for programmes for which it reported the need for potential additional financial corrections in the AARs, based on a thorough and robust methodology applied for each operational programme.

Moreover, an aggregated KPI is reported in the AARs as a weighted average of all confirmed error rates. The Commission also reported a maximum level of this KPI (worst-case scenario), taking into account all pending information still under validation. It also included, as from this year, a risk ‘top-up’ for certain OPs which have never been audited by the Commission itself or based on past audit findings of the audit authority.

Furthermore, the applicable provisions provide for the possibility for national authorities and the Commission to carry out audits and implement any required additional financial corrections in a multiannual period (including through audits carried out up to three years after the year in which accounts were accepted). This possibility offered by the co-legislator is important for the Commission to be able to discharge its responsibilities in relation to implementation of the EU budget under multiannual programmes.

Finally, the Commission reports in the respective AARs that for the previous accounting years, following the conclusion of contradictory procedures with programme authorities and, when necessary, the implementation by the national authorities of the relevant additional financial corrections, both DG REGIO and DG EMPL can conclude that the risk at closure is estimated well below 2%, as anticipated.
5.57 The Commission notes that the maximum values of its error estimate for MFF heading 2 / subheading 2a (2.3%/2.5%), that are considered in the AMPR for the calculation of the Commission’s overall risk at payment, fall within the ECA’s error range estimate.

5.59 The Commission refers to its replies under the special report mentioned by the ECA.

5.60 – First indent: The Commission considers that its detailed assessment based on a combination of desk and on-the-spot audit work covering the different individual programmes and assurance packages, depending on the risks attributed to them, allows it to establish a reasonable and fair estimate of the error rates for each programme and cumulatively for all programmes.

The Commission furthermore notes that its estimate of the level of error (KPI) disclosed in the 2019 and 2020 AARs is expressed as a range that includes maximum risks. While being below the ECA’s estimated level of error, this range falls within the interval calculated by the ECA for the 2019 and 2020 Statements of Assurance.

The published KPIs are confirmed by the Director-General for the relevant expenditure incurred in the reporting year. They are an estimate of the overall risk at payment for the Cohesion programmes taken together at the moment of their disclosure, taking account of all information available at that time.

Second indent: The Commission considers that the desk reviews it carries out for every programme each year is an efficient and proportionate approach for programmes that are found to reliably report low error rates year after year. For other programmes found to be more risky, on spot compliance audits complement the desk review.

The Commission’s desk review of 100% of received annual control reports and audit opinions is based on the information provided in the assurance package, taking account of cumulative knowledge and previous audit work carried out on the audit authority and OP concerned (including Commission’s own audits, ECA audits, and national system audit reports), and is completed by communication with audit authorities when deemed necessary to obtain clarifications or to carry out targeted verifications.

For the assurance packages received in 2021, DG EMPL recalculated the reported residual error rate for 38 programmes and DG REGIO for 49 programmes based only on the desk review.

As explained above, the Commission has completed its maximum risk calculation for programmes only subject to a desk review.

Third indent: As stated in the Commission’s audit strategy, the audit work focuses on those audit authorities on which the Commission was not yet able to place an adequate level of reliance, for which limited review was performed so far or for which new risks emerged. In addition, the audit of a certain number of other audit authorities as well, found to be less at risk, is needed over time as well. The new Joint audit directorate for Cohesion (the DAC) will ensure to sufficiently document the process for establishing its future audit plans to ensure that the links to the results of the risk assessment as well as other criteria considered are clearly disclosed and explained.

Fourth indent: In line with the 2014-2020 regulatory framework, the Member States certify the expenditure and report the results of their controls and audits in the assurance packages submitted by 15 February each year.

The reservations in the AARs are based on all information available at the time of the signature of the AAR, including the assessments of the impact of previous deficiencies on the most recent reported error rates and audit opinions.
For example, in its 2020 AAR, DG EMPL stated that four reservations were based on deficiencies or doubts as to the reliability of error rates reported in previous years and not yet solved. In case of doubts or identified risks, the Commission therefore applies a prudent approach for its own reporting in the AAR and estimates the level of risk for the concerned programmes at flat rate and expresses additional reservations where needed.

Verification of the legality regularity of expenditure is a continuous exercise during the period offered in the regulation to carry out audits, while the AAR provides a snapshot of the situation at a given time (April), for the relevant expenditure in the reporting year (requirement in the financial regulation). At the time of the signature of the AAR, the Commission cannot anticipate the results of audits that are taking place after that date. It will therefore continue its assessment and audit work to confirm or recalculate the reported error rates (which are not yet considered as final) and will request the necessary additional financial corrections where relevant. This will be reported in full transparency in the next AARs.

5.62 The Commission refers to its 2021 AARs explaining in more details its methodology on how maximum risks are calculated, based on a systematic desk review for each programme as well as risk-based compliance audits to confirm and/or adjust error rates reported by audit authorities, and applying a prudent conservative approach through top-up or flat rates to cover potential additional risks (see footnote 51 of DG REGIO AAR and footnote 73 of DG EMPL AAR). Regarding programmes audited in earlier accounting years, the Commission underlines that all its audits and related recommendations are duly followed-up with programme authorities and cannot be closed until all requested remedial actions are effectively in place, so that risks are properly mitigated and issues identified in the course of these audits do not longer occur. The Commission considers that this approach constitutes an efficient and reasonable source of assurance, also preserving cost-effectiveness of the controls under its responsibility.

5.63 – 5.64 In addition to its compliance audits, the Commission also carries out fact-finding missions and deskwork that can lead it to adjust residual error rates, possibly above 2% in certain cases. The Commission also carries out other types of audits, (e.g thematic audits or system audits at the level of managing authorities or intermediary bodies).

The Commission’s compliance audits were mostly risk-based in 2021. The Commission therefore considers that its audit results as reported by the ECA in this paragraph indicate that its risk assessment was pertinent. Moreover, with the creation of the Joint audit directorate for Cohesion, only one single audit is now carried out for multifund programmes or for regions with two monofund programmes. These audits would have been counted twice (one for each directorate general) in the past. The number of audits can therefore not be totally compared with previous years.

The Commission validates its audit findings with audit authorities in a contradictory procedure as laid down in the legal basis and monitors its final conclusions with a view to identifying the root-causes of the additional errors it has identified, and to improve the detection capacity of the concerned audit authorities.

In the respective AARs of DG REGIO and DG EMPL, the Commission reported serious weaknesses in the work of 15 audit authorities or their control bodies. Many aspects are looked at by the Commission to assess the effectiveness and reliability of the work of an audit authority, the error rate being only one of these. In a number of cases additional errors it detects are more occasional and despite a possible important extrapolated impact on the error rate these do not point to a systemic weakness at the level of the audit authority.

5.64 In 2021, audits by DG REGIO comprised 18 compliance audits, 15 fact finding missions and 13 thematic audits of which 4 conflict of interest.
DG EMPL’s audits covered 17 compliance audits and 4 fact findings, 3 thematic audits, as well as 2 audits in the UK, and 6 audits on the reliability of performance indicators.

No reference in annual activity reports to the ongoing rule of law procedure against Hungary

5.65 The 2021 Annual Activity Report of DG BUDG refers extensively to the general regime of conditionality, specifically in the section “Specific Objective 5.2 Strengthen the protection of the EU budget from financial risks including through EDES, the generalized deficiencies as regards the rule of law in the Member States by greater transparency, knowledge sharing and accountability achieved by regular dialogue between all concerned stakeholders”. This is complemented by the outputs for end of 2021/beginning of 2022 reported in Annex 2 of the 2021 Annual Activity Report of DG BUDG, under the heading “Leading the enforcement and implementation of the new conditionality Regulation for the protection of the EU budget”. The Conditionality Regulation is a horizontal tool which provides that appropriate measures shall be taken where it is established that breaches of the principles of the rule of law affect or seriously risk affecting the sound financial management of the Union budget or the protection of the financial interests of the Union in a sufficiently direct way. The Conditionality Regulation applies if no other procedures under Union law would allow to protect the Union budget more effectively.

The adoption of measures (which could include suspension of commitments, suspension of payments etc. in line with Article 5 of the Conditionality Regulation) is the responsibility of the Council (by qualified majority), upon a Commission’s proposal. Hence, the actions taken do not fall under the responsibility of any particular Authorising Officer by Delegation (AOD) and are reported at corporate level in the AMPR.

Since the Commission is under the obligation to fully respect the contradictory nature of the procedure under the Conditionality Regulation, it cannot anticipate the decision that the Council will eventually take if the Commission proposes measures.

The AOD will however take into account in his/her risk assessment relevant elements which may appear in the context of the procedure under the Conditionality Regulation and on which he has the possibility to act under the sectoral legal base.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

5.66 The level of error estimated by the ECA has remained stable compared with previous years. The Commission will follow up all errors found by the ECA and request additional financial corrections, where appropriate and legally possible.

The estimates of the level of error disclosed in the 2021 AARs of DGs REGIO and EMPL result from a detailed analysis of the situation of each programme.

The Commission notes that the maximum values of its error estimate for MFF heading 2 / subheading 2a (2.3%/2.5%) that are considered in the AMPR for the calculation of the Commission’s overall risk at payment, fall within the ECA’s error range estimate.

The Commission considers that in the cases identified by the ECA, for two transactions in relation to one 2007–2013 programme, there is no legal basis for imposing financial corrections.
The Commission also notes that more than one third of the ECA’s error rate estimate refers to just one programme at national level and reflects a very specific issue. It considers that the related projects were eligible, but not all costs should have been reimbursed.

**5.68** The objective of the current assurance model under Cohesion policy is to have a residual error rate below 2% for each programme individually, each year. If this is not the case, the Commission has the tools to detect the individual programmes concerned and to apply the necessary additional financial corrections, when the individual residual errors are confirmed to be above 2%.

**5.69** Management verifications are the first line of defence against errors and should be more effective in preventing and detecting errors in the first instance for a number of programmes. The Commission reports on the effectiveness of the functioning of management and control systems in the AARs of DG REGIO and DG EMPL (pages 39 and 59, respectively), and concluded that management and control systems had improved over time and now function well or sufficiently well for 90% of programmes.

**5.70** The Commission considers that, overall, reliance can be placed on the work of audit authorities and their control bodies, with the exception of a few instances reported in the AARs. In some cases, additional errors detected are occasional and do not point to a systemic weakness at the level of the audit authority.

Moreover, as per the legal requirements, in two cases the audit authorities calculated residual error rates including advances to financial instruments. For these cases, the Commission discloses in the AARs an error rate above 2% without such advances for the purpose of the KPI on legality and regularity, but cannot impose additional financial corrections.

For another assurance package with a RTER recalculated by ECA above 2%, there is no legal basis for additional corrections. The Commission therefore considers that the RTER remains below 2% in this case.

The Commission will continue to closely work with the managing and audit authorities of the programmes concerned, to follow up on agreed conclusions and to achieve over time a residual level of error below 2% for all programmes, using the regulatory instruments to apply additional financial corrections where deemed necessary.

**5.71** The Commission puts in place audit procedures to obtain reasonable assurance for each programme whether the error rates reported each year by the different audit authorities are acceptable, or whether there are indications or evidence that material levels of errors remain.

The fact that a residual error rate is found to be above 2% in a particular year, despite the audit authority having reported a rate below 2%, does not necessarily point to a serious or systematic deficiency in the work of the audit authority. Individual errors that went undetected, sometimes complex ones, may not always be representative of the work carried out by the audit authority and can be due to different interpretations of the applicable legislation (see also Commission reply to paragraph 5.70).

Moreover, the Commission assesses the work of audit authorities taking into account different parameters, including the results from system audits, in addition to the re-calculated error rates.

**5.72** In the AMPR, the Commission uses the risks at payment disclosed by the DGs in their AARs that underwent a careful and structured quality review.
Given its more detailed segmentation of expenditure according to risk profiles and control systems, the Commission, when detecting errors, and taking also account of the ECA’s work, is able to identify the specific part of the programme population that is most likely to be affected. It is thus able to give a differentiated view of the level of error across the payments made and to clearly identify the areas where improvements are needed.

The Commission notes that its estimates fall within the intervals estimated by the ECA. It considers that its detailed assessments lead to an estimate of the error rates that fairly reflects the reality of the situation on the ground for each programme and cumulatively for all programmes.

5.73 The 2021 Annual Activity Report of DG BUDG refers extensively to the general regime of conditionality, specifically in the section “Specific Objective 5.2 Strengthen the protection of the EU budget from financial risks including through EDES, the generalized deficiencies as regards the rule of law in the Member States by greater transparency, knowledge sharing and accountability achieved by regular dialogue between all concerned stakeholders”. This is complemented by the outputs for end of 2021/beginning of 2022 reported in Annex 2 of the 2021 Annual Activity Report of DG BUDG, under the heading “Leading the enforcement and implementation of the new conditionality Regulation for the protection of the EU budget”. The Conditionality Regulation is a horizontal tool which provides that appropriate measures shall be taken where it is established that breaches of the principles of the rule of law affect or seriously risk affecting the sound financial management of the Union budget or the protection of the financial interests of the Union in a sufficiently direct way. The Conditionality Regulation applies if no other procedures under Union law would allow to protect the Union budget more effectively.

The adoption of measures (which could include suspension of commitments, suspension of payments etc. in line with Article 5 of the Conditionality Regulation) is the responsibility of the Council (by qualified majority), upon a Commission’s proposal. Hence, the actions taken do not fall under the responsibility of any particular Authorising Officer by Delegation (AOD) and are reported at corporate level in the AMPR.

Since the Commission is under the obligation to fully respect the contradictory nature of the procedure under the Conditionality Regulation, it cannot anticipate the decision that the Council will eventually take if the Commission proposes measures.

The AOD will however take into account in his/her risk assessment relevant elements which may appear in the context of the procedure under the Conditionality Regulation and on which he has the possibility to act under the sectoral legal base.

5.74 In all advance purchase agreements, the Commission has the right to carry out on-the-spot checks and inspections until five years after the final payment. The verifications will thus take place in due course given the ongoing pandemic. See also Commission reply to Box 5.7.

Recommendations

5.75 - 5.77 The Commission rigorously follows up on the ECA recommendations that it has accepted with a view of implementing them within the timeframe agreed. For recommendation 6.1 from the ECA 2018 annual report the Commission is of the opinion that it has acted upon the recommendation, taking also into account the revised article 40 of the 2014-2020 CPR setting up a new assurance model for the SME initiative programmes.

Recommendation 5.1 - Method used for reimbursing beneficiaries when SCOs are applied to determine the EU contribution to the programme
The Commission accepts the recommendation, in particular in relation to the Irish programme audited by the ECA.

**Recommendation 5.2 – Contribution of national schemes to ESF objectives**

The Commission accepts the recommendation.

The Commission considers that the operations audited by the ECA contributed to the programme objectives, notwithstanding the fact that some ineligible participants were identified. The Commission will consider with the Member State alternative ways to deliver the audited YEI scheme under the ESF for the upcoming programming period.

**Recommendation 5.3 – Verification of NEET status by programme authorities**

The Commission accepts the recommendation.

The NEET status of young participants should be checked on the basis of reliable and verified sources, as much as possible and feasible, taking into account the fact that Article 16 of the ESF Regulation does not set out a definition of a person not in employment, education or training. Therefore, it is for the Member States to decide when to check the eligibility of the participants, as well as whether the criteria are met.

The Commission is also aware of the difficulty encountered by many ESF/YEI implementing bodies or beneficiaries to access confidential data linked, for example, to the absence of employment of participants.

For this reason, the 2021-2027 CPR does not refer any longer to NEETs as an eligibility criterion, but as a target group, and therefore only refers to “youth”, without determining any rules on the definition of the target group that is left to the discretion of the Member States.

**Recommendation 5.4 – Manufacturer compliance with advance purchase agreements for COVID-19 vaccines**

The Commission accepts the recommendation.

In all Advance Purchase Agreements, the Commission has the right to carry out on-the-spot checks and inspections until five years after the final payment.

While the Commission is committed to ensure compliance by COVID-19 manufacturers with the terms of Advance Purchase Agreements, it intends to carry out verifications based on a risk assessment.

The risk assessment will take into account whether the manufacturer obtained a conditional marketing authorisation for its COVID-19 vaccine and was able to deliver it to the Member States as well as whether Union budget was used for the upfront financing.

The checks will take place in due course given the ongoing pandemic. First results can be expected by late 2024 and actual completion by December 2025.

**Recommendation 5.5 – Audit trail for sampling by audit authorities**

The Commission accepts the recommendation.

The Commission will remind audit authorities about the need to provide appropriate explanations on their sampling procedures, and to ensure an appropriate audit trail.
**Recommendation 5.6 – Rule of law**

The Commission does not accept the recommendation.

The Commission will continue to refer to general conditionality procedures only in the AMPR and the AAR of DG BUDG. The general regime of conditionality or the protection of the Union budget concerns the entire EU budget, and not just specific programmes or policy areas, as reflected in corporate reporting. Moreover, the Commission and its AOD cannot pre-empt future decisions by the Council which is the responsible institution for the adoption of the relevant measures.
INTRODUCTION TO THE COMMISSION REPLIES

6.1 The Commission welcomes ECA’s estimated level of error of 1.8% for the policy area “Natural Resources and environment”, which is below the materiality threshold and in line with the Commission’s own assessment of the risk at payment. The Commission is also pleased to see that Common Agricultural Policy (CAP) Direct Payments remain free of material error, confirming thus the important role played by the Integrated Administration and Control System (IACS), including Land Parcel Identification System (LPIS), in preventing and reducing the level of error.

The CAP is a genuinely European policy as Member States pool resources to operate a single common policy with a single European budget. With 6.6 million beneficiaries, the CAP expenditure is implemented under shared management through a comprehensive management and control system, which is designed to ensure the legality and regularity of the underlying transactions at the level of the final beneficiaries.

The robust assurance model of the CAP includes the first level controls by the paying agencies, the audit work carried out by the independent certification bodies and the Commission’s own work through the clearance of accounts.

The Commission welcomes the ECA’s assessment that the systems of the Paying Agencies are overall reliable and provide correct calculation for the aid amount, which is in line with the Commission’s own analysis.

The Rural Development measure 21 was created with a view to provide easy-to-access crisis support to those most affected by the crisis, by being as simple as possible for the beneficiaries as well as for the administration. The Commission welcomes the ECA assessment that in general the conditions for support were respected.

Checks by Monitoring is a control approach defined in the current EU legal framework. From 2023 onwards the mandatory Area Monitoring System will cover area-related interventions across all Member States for the purpose of measuring policy performance focussing on agricultural activities. Since rural development measures in particular are prone to contain eligibility conditions that are not monitorable with Sentinel satellite data, the Commission’s proposal for a future Area Monitoring System in Member States foresees also the use of Non-Sentinel data.

REGULARITY OF TRANSACTIONS

6.14 The Commission welcomes ECA’s assessment of the error in the Natural resources chapter and is pleased to note that the ECA’s error rate is below the materiality threshold of 2% and remains closely in line with its own estimate (1.8%) for CAP expenditure, as presented in the Commission AMPR and DG AGRI’s Annual Activity Report (AAR).
Box 1 - A paying agency failed to use all available information when checking a beneficiary’s declared costs

With a view to ensuring a safe implementation of the wine promotion measure, in 2016 DG AGRI issued guidelines on national support programmes in the wine sector, in particular on the promotion measure. In addition, in 2021, DG AGRI issued a note to the Member States’ delegates on 'technical issues detected in wine – promotion in third countries'. This should contribute to mitigate the risks in terms of implementation of the promotion measure in the wine sector.

In relation to this specific transaction, the Commission will follow up to ensure that any undue payments are corrected.

Direct Payments

6.18 The Commission is pleased to note that out of the 84 transactions tested, in only three the ECA found minor overstatements, which were all below 5%.

6.20 The Commission welcomes ECA’s positive assessment of the role of Integrated Administration and Control System (IACS) including the Land Parcel Identification System (LPIS). The Commission considers IACS including LPIS as efficient in preventing and reducing the level of error.

Area/animal-related rural development spending

6.23 The Commission would like to point out that the two errors mentioned regarding the inaccurate data on beneficiaries recorded in its animal database, and which both occurred in the same paying agency, were not due to wrong declarations by the beneficiaries, but due to a technical issue in the animal database, which affected the declarations of a limited number of beneficiaries. The concerned paying agency has initiated procedures to identify all affected beneficiaries and to recover the undue amounts. The technical issue has been solved for the 2022 claim year.

Investment Projects

6.25 The Commission does not agree with ECA’s assessment in two transactions.

Checks by monitoring

6.28 Checks by Monitoring is a control approach defined in EU legal framework that relies on field visits (for non-monitorable eligibility criteria, commitments and obligations) and the use of new technologies (for monitorable eligibility criteria, commitments and obligations) as an alternative to traditional control approaches for area-related aid schemes and measures.

All in all, the Commission considers that the checks by monitoring is a very good example of how technology can be applied to make management and control systems more effective.

In 2021, 10 Member State and almost 30 paying agencies opted for Checks by Monitoring.

6.29 Where the eligibility conditions of area-related aid can be considered 'monitorable' with Sentinel satellite data (or other data with at least equivalent value), the Checks by Monitoring approach uses automated processes to check for compliance. Non-conclusive outcomes are followed up with semi-automated procedures. Where eligibility conditions of area-related aid are a priori not 'monitorable' with Sentinel satellite data, then field visits have to be carried out on a sample of beneficiaries. The advantage of the Checks by Monitoring approach over traditional control methods is, thus, highest when all eligibility conditions can be monitored. However, rural development measures in particular often contain eligibility conditions that are not monitorable with Sentinel satellite data. To address this, the Commission’s proposal for a future Area Monitoring System in Member States foresees the use of Non-Sentinel data such as geotagged photos.

6.30 In 2021, the uptake of the Checks by Monitoring approach in Member States doubled with respect to that of 2020 thus exceeding the Commission’s interim milestone of 10% of the utilized agricultural area by 2022.

6.31 The Commission would like to draw attention to the fact that as of 2023 Member States may design their management, control and penalty systems in accordance with the Basic Union requirements set out in Regulation (EU) No 2116/2022. From 2023 onwards, the mandatory Area Monitoring System will cover area-related interventions across all Member States for the purpose of measuring policy performance. This mandatory use of Copernicus Sentinel satellites data in the next CAP is introduced to ensure the reliability of the annual performance reporting of Member States. The underlying information the Area Monitoring System will provide can be used by Member States to prevent errors, detect irregularities and thereby to reduce risks to the Funds.

6.35 The Commission has been encouraging the uptake of the Checks by Monitoring approach already from 2018 onwards. Apart from providing free access to the Copernicus Data and Information Access Services (DIAS) for CAP monitoring purposes, the Commission has developed guidance documents, and is facilitating mutual learning and the exchange of best practices among Member States, for example, by organising dedicated meetings where Member States who already use Checks by Monitoring provide insights and share experiences based on their actual implementation. In addition, the Commission supports Member States with trainings, documentation and IT solutions in the context of its Checks by Monitoring outreach effort which aims to tackle perceived or actual technical hurdles in the use of Sentinel satellite data for CAP monitoring.

As a result, in 2021 the uptake of the Checks by Monitoring approach in Member States doubled with respect to that of 2020 thus exceeding the Commission’s interim milestone of 10% of the utilized agricultural area by 2022.

**Coherence checks of Member States’ control statistics and payments data**

6.37 The Commission welcomes ECA’s assessment that the systems of the Paying Agencies are overall reliable and provide correct calculation for the aid amount. The Commission carries out its own analysis in the form of annual quality reviews of the payment and control data submitted by the Paying Agency as well as data integrity audits on Paying Agencies’ information systems, which confirm the ECAs assessment.

**Rural development measure M21**

6.39 The Commission welcomes the ECA assessment that in general the conditions for support were respected. The idea was to create schemes as simple as possible for the beneficiaries as well
as for the administration, in line with the purpose and idea of the measure to provide easy-to-access crisis support to those most affected by the crisis.

M21 is a non-IACS measure, providing lump sum payments usually not linked to the number of hectares or animals. According to the regulations, it is therefore not covered by the IACS rules, and it was not required to use the IACS system.

The Commission would also like to point out that the ECA did not identify any undue payments in any of the seven transactions under M21 audited for the purpose of the DAS.

6.40 M21 is a non-IACS measure, and according to the regulations not covered by the IACS rules. It was therefore not required to use the IACS system, but for the Member States to decide on the administrative systems to be used for the implementation of the measure.

Box 4 - Examples of beneficiaries not meeting the criteria of measure M21

In the case of the Romanian Rural Development Programme, if the categories of beneficiaries mentioned were “active farmers”, they were entitled to receive the aid. No selection criteria were imposed under the measure.

ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

6.42 In this seventh year of delivering an opinion on legality and regularity of expenditure, the Certification Bodies’ reports contain substantial and valuable information on the legality and regularity of expenditure that has been examined in detail by DG AGRI auditors and taken into account for their assessment of the adjustments to be made to the error rates reported by the Paying Agencies. The Certification Bodies reached a level where they deliver sound and substantial results on the legality and regularity of the expenditure for all populations. Based on the substantial work performed by the Certification Bodies and the increased number of findings, DG AGRI placed reliance on the results of the Certification Bodies’ work on legality and regularity. In addition, based on the revised guidelines where the Certification Bodies’ incompliance rate could be directly compared to the Paying Agencies’ control statistics, the Certification Bodies’ results were the basis for the calculation of DG AGRI’s adjusted error rate for financial year 2021.

6.44 The Commission further notes that as a result of all corrective actions for the CAP (estimated at 1.5%), the estimated final amount at risk (risk at closure) for the CAP in 2021 is estimated at 0.3 %. (see AAR 2021 p. 90).

6.46 The Commission notes that the risk at payment for ‘Natural resources and environment’ presented in its AMPR is at the same level as the ECA’s estimated level of error of 1.8 %, which is below the materiality threshold of 2%.
CONCLUSION AND RECOMMENDATIONS

Conclusion

6.47 The Commission welcomes the fact that the ECA’s estimated level of error for this chapter, at 1.8 %, is below materiality (2.0 %) and is the same level as the Commission’s estimated risk at payment for this heading in the AMPR.

Follow-up of recommendations made in the 2019 Annual Report

6.49 The Commission makes reference to the conclusions and its replies in the ECA Special Report 14/2022 - The Commission’s response to fraud in the common agricultural policy - Time to dig deeper. The Commission has taken actions to address the issues identified and it will update the fraud risk analysis in light of the new CAP.

6.50 See Commission reply to paragraph 6.49.

The Commission will do the necessary to implement the recommendations issued in Special Report 14/2022.

Recommendations

Recommendation 6.1 – Support the use of new technologies for preventing errors in CAP payments

The Commission accepts the recommendation.

The Commission will provide a forum for facilitating the sharing of best practices in the use of new technologies.

As from 2023 onwards the mandatory Area Monitoring System will cover area-related interventions across all Member States for the purpose of measuring policy performance focusing on agricultural activities. The role of the AMS is to identify cases where the eligibility conditions are not met. For those cases, Member States must provide the beneficiary with the chance to remedy the situation.

Recommendation 6.2 – Checks of measure M21 payments

The Commission accepts the recommendation.

Measure M21 was adopted and implemented by administrations in record time in view of the urgency of the situation. The ECA concludes that in general, the conditions for support laid down in the regulation were respected, and it identified only a limited number of cases where beneficiaries who did not meet the criteria for support received funds. The measure is subject to Commission audits as well as the monitoring and evaluation system for the European Agricultural Fund for Rural Development (EAFRD), and the Commission will encourage Member States to cover this measure in their ex-post evaluations of the CAP.
**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS’ 2021 ANNUAL REPORT**

“CHAPTER 7 – MIGRATION AND BORDER MANAGEMENT, SECURITY AND DEFENCE”

**INTRODUCTION TO THE COMMISSION REPLIES**

The Commission welcomes the ECA’s observations and commits itself to engage in the areas where the need for improvements has been identified, in order to reduce the number of errors in the future.

Despite the reported cases, the control strategy put in place by the Commission for the provision of emergency assistance is functioning satisfactorily. The Commission will take on board the recommendations while pointing at the particularly difficult context in which emergency actions are carried out by the beneficiaries.

The management of most AMIF and ISF funding for 2014-2020 is shared with the Member States (and Schengen Associated Countries). The Commission welcomes the acknowledgment that the Audit Authorities, despite certain shortcomings, some of which were already identified by the Commission, had developed and implemented detailed procedures of sufficient quality to report on their work and used checklists to support their conclusions.

7.8 Following the influx of displaced persons from Ukraine to the Union, caused by invasion of Ukraine on 24 February 2022, Regulation 2022/585 of 6 April 2022 extended the implementation period of the 2014-2020 Funds until 30 June 2024, providing Member States with additional flexibility to use remaining funding.

**REGULARITY OF TRANSACTIONS**

7.10 The Commission considers that, in one case, there is no error at Commission level.

The Commission takes note of an error found at an Agency in 2020, but does not consider that it affected Commission’s payment audited in 2021, for the clearing of the pre-financing of the EU contribution to this Agency. This error occurred at the level of the Agency for which the authorising officer of the Agency is responsible. The Commission recalls that it pays a balancing contribution to the Agency, based on its outturn account. The Commission had no other option but to clear the pre-financing related to the EU contribution as all legal conditions to make the clearing were met.
Box 7.1 Examples of errors

**Acquisition of ineligible vehicle types**

For the clearance of accounts for Financial Year 2021, following the ECA’s audit work, the Commission took precautionary measures by withholding 10% of the annual accounts via a partial clearance as reported in the 2021 Annual Activity Report. The Commission will launch a conformity clearance procedure to determine the financial risk for past accounts and the amount of the net financial correction to be applied.

**Ineligibility of declared accommodation costs**

The action was carried out in an emergency situation within the meaning of the Asylum, Migration and Integration Fund (AMIF) basic act. The project was implemented in an exceptional context characterised by a steady increase of the number of asylum seekers. This emergency situation arose from the lack of capacity to meet the demand and the risk of failing to meet the national legal obligations to provide material reception conditions to asylum seekers.

The Commission acknowledges that the absence of documents has not allowed the ECA to verify the correct implementation of the procurement procedure. However, in view of the information provided by the Irish authorities, and in the light of the audit certificate, which should be based on the full documentary evidence, the Commission expects that the procedure was correctly implemented.

The Commission considers that the procedure put in place by the Irish authorities provides sufficient guarantee that the eligibility of the target population was met.

The accommodated guests are assigned to the hotels by the Irish International Protection Office. Internal procedures exist to analyse the claims for international protection and for the assignment of applicants to the different accommodations.

The provision of the services, accommodation and meals is not questioned and the Commission is satisfied with the operational results of this emergency assistance project.

In light of the findings, a mission will be organised to Ireland to ensure appropriate procedures to address the deficiencies identified are put in place and the Commission will proceed to the determination of the amount to be recovered from the beneficiary.

---

**EXAMINATION OF ELEMENTS OF INTERNAL CONTROL SYSTEMS**

**Audit authorities’ work**

**7.13** The Commission takes note of ECA confirmation on the quality of the underlying audit work of the national Audit Authorities as reported in the ACR for the clearance of accounts for financial year 2020.
As acknowledged by ECA, the Commission had already identified all of the shortcomings identified by ECA during its audit work for DAS 2021 and took the appropriate mitigating measures as part of the decision for the clearance of accounts for financial year 2020.

**Box 7.2 Shortcomings in annual control reports**

As regards the case of absence of random sampling for audits of expenditure in Malta, the Commission had already identified this shortcoming in the analysis of the Annual Control Report (ACR) for the Financial Year (FY) 2020. In the Commission’s view, a risk-based sampling method may lead to an overestimation of the overall error rate thus reducing the risks to the EU budget. Notwithstanding, in the feedback letter to the Audit Authority dated 23.06.2021 the Commission reminded the MS to draw the audit sample randomly as per Delegated Regulation and, if the Audit Authority considers it necessary to cover certain risks, to draw a complementary risk based sample.

As regards the submission of the draft accounts to the audit authority before the responsible authority completed its own controls (Malta), the Commission had already identified this shortcoming in the analysis of the ACR for FY 2020 and a recommendation was issued to the MS in the partial clearance letter on 14.06.2021 addressed to the Responsible and Audit Authorities as well as the feedback letter to the Audit Authority on 23.06.2021.

As regards the absence of explanation for the differences between the draft and final accounts (Sweden), the Commission had already identified this shortcoming in the analysis of the ACR for FY 2020 and a recommendation was issued in the feedback letter to the Audit Authority on 03.06.2021 to include in the ACR any relevant information that could help the Commission services reconcile the amounts included in the final accounts and the auditable population (the draft accounts) reported in table 10.2 column B.

As regards the inaccurate presentation of the residual error rate, and incorrect audit opinion (Malta), the Commission had already identified this shortcoming in the analysis of the ACR for FY 2020 and mitigating measures were implemented. The Commission proceeded with a partial clearance and subsequent cancellation of the amount of EUR 16 398.70 from the clearance decision as communicated to the MS by letter on 22.12.2021, thus ensuring that the total residual error rate was below materiality.

As regards incomplete reporting on audits of expenditure relating to negative payments or payments to clear advances declared in a previous year’s accounts (Bulgaria), the Commission had already identified this shortcoming in the analysis of the ACR for FY 2020. The Bulgarian Audit Authority provided the information in the ACR but incorrectly presented. Following clarifications between the Commission and the Audit Authority during the clearance of accounts for FY 2020, the Commission could reach the correct conclusions. The Audit Authority was requested in the feedback letter on 03.06.2021 to ensure improvement of reporting in the correct tables for the next ACRs.

**7.14** Overall, the Commission considers that the shortcomings have limited impact on the assurance because either they were not material or (as for the Bulgarian ISF deficiencies) the Commission has taken immediate measures to address the risks to the EU budget stemming from the type of shortcomings identified by the ECA, and took them into account for the clearance of accounts for FY 2021.
Box 7.3 Shortcomings in the work of audit authorities

As regards the check of project selection process (Sweden), the Commission considers the risk as limited taking into account the Swedish Audit Authority had confirmed that the system audit on KR 2 –“selection process” was performed for FY 2019 and no significant weaknesses were identified. Moreover, the standard checklist was promptly updated to address the detected weaknesses.

As regards the check of procurement procedure (Bulgaria), the Commission takes note of the ECA’s findings. For the clearance of accounts FY 2021, the Commission took precautionary measures by withholding 10% of the annual accounts via a partial clearance as reported in AAR 2021. The Commission will launch a conformity clearance procedure to determine the financial risk for past accounts and the amount of the net financial correction to be applied.

As regards the testing of eligibility of expenditure in Sweden and Bulgaria, for Sweden, the Commission considers the risk of ineligible expenditure as limited as the Audit Authority proceeded with the relevant checks, even if there were some minor weaknesses in their documentation. For the verification of the variable element, the Audit Authority opted to rely on one of the official databases, and it appears that, while there might be some deficiencies to this approach, there are only minor differences against other databases.

For Bulgaria, as indicated above, the Commission will launch a conformity clearance procedure to determine the financial risk for past accounts and the amount of the net financial correction to be applied.

As regards the audit trail and documentation of audit work and results in Sweden and Bulgaria:

For Sweden the Commission considers that these reveal minor weaknesses in the documentation of specific checks and/or audits. Furthermore, these cases do not, in any way, put in question the audit work performed by the Audit Authorities, nor the reliability of their conclusions.

For Bulgaria, the Commission considers that these reveal weaknesses in the documentation of specific checks and/or audits.

To remedy in the future this kind of weaknesses identified in both countries, and in response to previous findings and the ECA’s recommendations, DG HOME shared with the Audit Authorities for HOME Funds a “Reflection Paper on Audit Documentation – Good practices from and for auditors”. This paper is the result of a working group between Commission audit services for shared management and Member States national Audit Authorities to identify and develop best practices to improve the documentation of their audit work.

ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

7.16 The Commission recalls that the Director General’s declaration of assurance is based on the examination of several pieces of information from multiple sources (self-assessment, ex post controls, IAS and ECA reports) ensuring its reliability.
CONCLUSION AND RECOMMENDATIONS

Recommendations

Recommendation 1 – Audit trail and procurement

The Commission accepts the recommendation, considers that it is already being implemented and will continue to take action.

In relation to beneficiaries of Home Affairs funds and the Member State authorities responsible for their implementation, the Commission is constantly providing guidance and support in relation to procurement rules and audit trail.

This is evidenced also by actions taken by the Commission in implementation of recommendations issued by the ECA in 2018 (i.e. in relation to procurement both for direct and shared management).

Recommendation 2 – Eligibility of project costs for actions directly managed by DG HOME

The Commission partially accepts the recommendation.

The Commission accepts the recommendation in so far as it relates to emergency assistance. The Commission does not accept the part of the recommendation related to Union actions, which have been already reinforced following the implementation of 2018 recommendations.

A methodology for the analysis of the final requests for payments in the context of Union actions and emergency assistance as well as dedicated check-lists already exist. Before the final payments are executed ex-ante-controls are applied, as necessary.

Following the findings of the ECA, the existing Control Strategy for Emergency assistance of December 2017 will be developed further and ex-ante checks on the eligibility of expenditure will be reinforced as appropriate in view also of the updates required by the new MFF.

The model Grant Agreements define the requirements for the certificate on the financial statements and the audit methodology to be applied by auditors.

The audit certificate is only one of the elements for the Commission ex-ante assurance in the implementation of the Union Actions and the emergency assistance. Before the final payments are executed other ex-ante-controls are applied, as necessary.
INTRODUCTION TO THE COMMISSION REPLIES

The Commission welcomes the ECA findings for this chapter and is committed to implementing the appropriate remedial action where necessary. In reply to some observations related to DG NEAR residual error rate study, the Commission provides clarifications on the features of the study and its contribution to building the annual declaration of assurance, along with the other elements of the internal control framework.

REGULARITY OF TRANSACTIONS

Box 1 - Expenditure partially not yet incurred

DG NEAR

As the final amount chargeable to the EU budget will be determined only upon receipt of the final report issued by the beneficiary, the Commission considers the error as temporary. It will no longer exist after the final clearing.

DG INTPA:

The context of the country at that moment in time allowed the EU Delegation to go for direct award if they wished so, considering that the country benefited of the Declaration of crisis and therefore application of flexible procedures. Nevertheless, the EU Delegation sought to open, as much as possible, the competition in a fast way, by using a negotiated procedure.

Seven of these companies were listed under a framework contract in areas of the ones requested by the contract. The eighth company had also similar experience from previous contracts in the area and was selected following its expression of interest. On this basis, the Commission considered that all eight entities had the capacity to participate to the competitive negotiated procedure. The Commission acknowledges that this could have been better documented.

8.9 The Commission has followed the cases identified by the ECA closely and is committed to implementing the appropriate remedial action where necessary.

However, regarding the cases of non-compliance related to the selection of projects and the application of procurement rules, the Commission considers that the beneficiaries applied the relevant rules correctly, in line with their own rules and procedures, as foreseen in the agreement’s contractual provisions.
Box 2 - Conditions for budget support instalments

The Commission considers that its guidelines for budget support are very clear in terms of bank account requirements and exchange rate.

The controls concerning drafting of the financing agreements will be reinforced by reviewing the related checklist, in order to ensure full compliance and alignment with the existing guidelines on budget support.

8.12 Under the notional approach, the EU cost eligibility requirements are met as long as the action includes an amount of costs eligible under EU rules equivalent to the EU contribution and the amount contributed by other donors is sufficient to cover the costs that are ineligible under EU rules (Article 155(5) of the Financial Regulation). This makes it possible for the EU to contribute to multi-donor actions without the earmarking of funds (i.e. jointly co-financed actions). There are no legal obligations for the Commission to report separately on the proportion of funds, entrusted to implementing partners, to which the notional approach applies.

8.14 The Commission is aware of the cases of access to documents in read-only format identified by the ECA and continues to draw the attention of the concerned International Organisations of the United Nations to the need to provide the auditors with the necessary information.

The Commission is working closely with the International Organisations concerned and the ECA to find acceptable solutions to the issue of access to documents.

The Commission observed that the limited access to documents concerned three projects implemented by UN organisations. When these cases were brought to the Commission’s attention, the Commission staff at headquarters and in the field reacted quickly and enhanced the dialogue with the concerned UN organisations and their headquarters to facilitate the ongoing work and speed up the provision of replies/documents.

ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

The Residual Error Rate (RER) study

8.20 The Residual Error Rate (RER) study is an important element underpinning the declaration of the Director-General, though is not the only source of assurance. DG NEAR has a comprehensive internal control framework and control strategy covering the full implementation cycle. All elements of the control framework serve as building blocks for its assurance.

8.21 The Commission notes that the additional grant rate is based on an additional sample of 64 transactions. The error rate stemming from the additional grant sample provides corroborative and enhanced information on grants management, complementing the grant-related information coming from the grants included in the main sample. All three rates (main, ‘indirect management by beneficiary countries’ and grants) are examined and DG NEAR takes into account the results of all ex-post controls for the assessment of its internal control, the declaration of assurance signed by the Director-General and the reporting in the Annual Activity Report.
8.22 The Commission does not characterise the RER study as an assurance engagement or an audit. It serves a specific purpose and is built on a distinct methodology. This is disclosed in the RER study and in DG NEAR’s Annual Activity Report, which presents complete management information in a true and fair manner. The Commission considers that the study is not subject to limitations that may contribute to an underestimation of errors.

8.23 The RER ex-post controls are performed on a sample (representative of the population) of closed contracts, not on the whole population. It is the inherent feature of the study that some ‘old contracts’ will not be subject to the RER review. The main reason why the Commission excludes old contracts from the RER study, in line with its methodology, is that it considers that the information coming from ex-post controls of these contracts would be of little value to improve the internal control framework. This is because contracts characterised by no operational activity in the last eight years and/or no controls in the last five years were implemented under rules and regulations that are no longer applicable. Moreover, after the end of the implementation period, beneficiaries are obliged to keep supporting documentation for a period of 5 to 8 years. This time limitation would hinder the possibility to carry out the controls, and result in a number of transactions not contributing to the calculation of the error rates.

8.24 The Commission notes that the RER study included these grants in the additional grant population; hence they were subject to ex-post controls. However, they were not included in the main sample, in compliance with a service-level agreement concluded between DG INTPA and DG NEAR. Following the entry into force of the new service-level agreement between the two Directorates-General in July 2021, they will be included in the population from which the main sample is derived, starting from the RER study 2022.

8.25 The Commission notes that the thematic grants represented around 3% of the portfolio of closed contacts in 2021. Thematic grants were subject to the RER ex-post controls, as they were included in the additional grant sample. The “old contracts” (the remaining 17%) are not part of the RER population, as per applicable RER methodology which provides the relevant criteria and the rationale.

For these reasons, the Commission considers that not including the old contracts in the population is not a limitation, but a feature of the study, which consists in removing data from the population not relevant to the study.

The format of the Annual Activity Report does not lend itself easily to disclosing all technical features of the RER study. These are described in more detail in the RER methodology and manual. However, in order to fully address the ECA recommendation, DG NEAR will disclose the information concerning “old contracts” starting from the next Annual Activity Report.

CONCLUSIONS AND RECOMMENDATIONS

Follow-up of recommendations made in the Annual Reports 2018-2020

8.28 Regarding the recommendation no. 1 from 2018 and 2020, the Commission intensified communication with International Organisations on ECA’s access to documents.
In the UN FAFA working group of October 2021, the Commission underlined the need for the UN to provide to the ECA any document or information necessary to carry out its audit work and the issue of read-only access.

The Commission organised a technical meeting in October 2021 with representatives of some UN entities on access to documents. The UN committed to develop a standard tool and approach in order to facilitate the work of the ECA.

However, some International Organisations continued to provide only limited access to documents, such as in a read-only format.

The Commission is working closely with the International Organisations concerned and with the ECA to find acceptable solutions to this issue.

**Recommendations**

**Recommendation 1 – Deduct costs not incurred before payment or clearing**

The Commission accepts the recommendation.

A reminder of existing instructions for clearing will be issued, to raise awareness among the authorising officers on this matter, and remind them that, at the time of the clearing, they should have reasonable assurance that the cost reported are incurred by the beneficiary and accepted by the international organisation.

**Recommendation 2 – Strengthen controls when drafting financing agreements for budget support operations**

The Commission accepts the recommendation.

The Commission considers that the templates for the financing agreements are fit for purpose and that, together with the budget support guidelines, they provide clear guidance regarding the transfer of funds to the beneficiary country’s treasury account and the applicable exchange rate. The Commission considers that the provisions are used appropriately but, to provide reassurance that they are always spelled out clearly in the financing agreement according to each country context, the Commission will strengthen controls by reviewing the related checklist for financing agreements. The Commission nevertheless points out that in rare cases countries do not have a Central Bank and in these cases the recommendation will be applied mutatis mutandis in view of the country context.

**Recommendation 3 – Disclose contracts excluded from RER population**

The Commission accepts the recommendation.
REPLIES TO THE COURT’S OBSERVATIONS REGARDING PARLIAMENT

9.8

In accordance with Article 1 of the Rules on the use of appropriations from budget item 400 (“Rules”), the political groups manage the funds allocated to them according to the principles of indirect management of funds in analogical application of Article 62(1)(c) of the Financial Regulation. Those Rules replace the “contribution agreements” (as referred to in Article 155(6) of the Financial Regulation), which cannot be signed by the groups with a legally binding effect.

The position of the European Parliament’s administration is that Article 175(1) and Article 163(1) of the Financial Regulation defining the use of negotiated procurement procedures for high-value contracts are not applicable to the political groups as those provisions only apply to direct management.

As a follow-up to previously reported shortcomings relating to procurement by political groups in 2015 and 2016, Parliament’s administration provided guidelines on procurement and organised trainings for the political groups.

The European Parliament takes note of the observations of the Court. According to Article 1.4 of the Rules, the political groups shall be responsible to the institution for the use of appropriations, within the limits of the powers conferred upon them by the Bureau for application of these rules. Parliament’s administration will continue to support the political groups with the objective that the appropriations are used in accordance with these rules and that they take appropriate action to prevent any expenditure, which is not in accordance with these rules.

9.9.

Following the decision of Parliament’s Bureau of 5 October 2020, the public procurement procedure for the acquisition of the building on Wiertz street in Brussels was conducted by Parliament in line with the Financial Regulation and all applicable internal rules and procedures as well as with the strictest respect of the principle of non-discrimination towards all potential bidders. The objective of the procedure was “the purchase of buildings inside or
very close to its central interconnected core buildings”, as stipulated in the underlying Bureau Note.

The information notice of the procedure, as it had been published in the Official Journal of the European Union of 28 October 2020 (2020/S210-511911) stated explicitly the objective to search for office space for Members, parliamentary assistants and staff of the European Parliament. In order to pursue equal treatment of Members with regard to proximity of their offices to the chamber, the distance criterion played a major role within the quality criteria. The weighting factor of the distance criterion has been set at 20 points out of 50 quality points. In addition, the possibility of interconnection with the central buildings received an additional weighting factor of 4 points out of 50 quality points in order to be aligned as much as possible with the objective set by Parliament's Bureau. Similar weightings for proximity have been used by other Union institutions for the acquisition of buildings. Based on case law of the European Courts, the contracting authority enjoys a broad discretion as to the choice, content and implementation of the relevant award criteria related to the contract at issue, including those the purpose of which is to determine the most economically advantageous tender. Parliament considers that the building on Wiertz street has been the most economically advantageous offer taking into consideration the price and the targeted needs and objectives pursued by the contracting authority as defined by Parliament’s Buildings Strategy adopted by the Bureau.

Furthermore, the situation in which Parliament would not have acquired the building has to be taken into consideration. The usufruct contract for the building on Wiertz street signed by Parliament in 2009 did not include any possibility for an exit clause. If Parliament had not acquired the building, it would have been obliged to pay the annual usufruct payments for the remaining contractual period until 31 May 2027 anyway. Additionally, Parliament would have lost the already realised investments into modernisation, security and interconnection of that building.

**REPLY TO THE COURT’S RECOMMENDATION REGARDING PARLIAMENT**

**Recommendation 9.1.**

The European Parliament accepts the Court’s recommendation.

Parliament will continue to assist the political groups with the aim to improve their internal financial management. In particular, it will further clarify the guidelines on procurement by political groups and it will propose to better align the Rules on the Use of Appropriations from Budget Item 400 to the Financial Regulation.

---

1 General Court's ruling in case T-556/11, paragraph 215.
The Commission welcomes the ECA’s overall conclusion that the level of error in spending on ‘European public administration’ was not material.

With regard to the observations related to the pension payments (paragraph 9.10), the Commission would like to point out that the decision to suspend the obligation for life declarations took effect between June 2020 and November 2021. All agents have/will be notified to send any remaining declarations as before.

With regard to the observations related to the follow-up review of the 2018 recommendation on family allowances (paragraph 9.19), as confirmed by the ECA, the monitoring of allowances received from elsewhere is complex. Since the regularization of allocations received from other sources can only be made on the basis of the declarations of the agents, the update of the relevant files can only be carried out a posteriori and not in real time. The Commission has implemented reinforced consistency checks and has managed to recover overpaid amounts almost with no delay.
INTRODUCTION TO THE COMMISSION REPLIES

In 2021, the Commission assessed and endorsed 22 Recovery and Resilience Plans (RRPs) which have been subsequently approved by the Council. Following signature of the financing and loan agreements, the Commission disbursed the pre-financing payment of up to 13% of the financial contribution to the 21 Member States which requested it (of which 20 in 2021). At the end of the year, the Commission carried out the assessment of the first payment request submitted by Spain and executed the corresponding payment in December 2021.

In 2021, the Commission set up and started to implement audit and control strategies for the RRF; systematic ex-ante controls of all milestones and targets included in each payment request are conducted and an RRF audit strategy is rolling out.

The audit strategy includes risk-based audit work on the payment requests as well as system audits on (i) the systems implementing milestones and targets and, (ii) the systems underlying the protection of the financial interest of the European Union. For audits of payment requests, the Commission intends to audit all milestones and targets considered high-risk. For system audits, at least one audit per Member State is planned by the end of 2023.

In case only a subset of milestones and targets of a payment request are satisfactorily fulfilled, the legal framework of RRF Regulation provides flexibility to the Commission to decide upon the amount of an instalment to suspend. The Commission is developing a methodology to provide equal treatment. However, the Commission did not need it in 2021, as it assessed all milestones included in the first payment request submitted by Spain as satisfactorily fulfilled.

REGULARITY OF TRANSACTIONS

Assessment of criteria associated with milestones and Targets

10.22 The Commission based its assessment of satisfactory fulfilment of the milestones on its description and on the relevant elements contained in the description of the related measures, both of which were set out in the related Council Implementing Decision (CID) and the verification mechanism provided for in the operational arrangements.

10.23 The initial version of the internal guidelines, which was applicable at the time of the Spanish payment request, beyond asking that all elements contained in the description of the milestone/target in the CID as well as the elements included in the description of the measure in the CID should be fully complied with “as a rule”, also provided for exceptions where this may not be the case. This is in line with the concept agreed by the co-legislators in the RRF Regulation that the Commission assesses the “satisfactory” fulfilment, which leaves a certain level of discretion to the Commission when analysing the different elements.
Concerning milestone 395, in accordance with Article 24(3) of the RRF Regulation, the Commission assesses “whether the relevant milestones and targets set out in the Council implementing decision... have been satisfactorily fulfilled.” The element that the ECA has identified as not assessed (and considers not fulfilled) is not in the milestone, but is contained in the description of the measure. As per Article 20(5)(c) of the RRF Regulation, the description of the measure is a separate part of the Council Implementing Decision compared to the milestones and targets, which are covered by Article 20(5)(e) and (f). As such, the Commission considers that not all elements of that description are always relevant for the Commission’s assessment on the satisfactory fulfilment of milestones and targets.

The Commission has acknowledged that its internal guidelines on the assessment of milestones and targets were not clear enough and has taken steps to address this. The Commission considers that the element of the description of the measure that ECA refers to is not directly or indirectly referred to in the milestone, nor is directly or indirectly relevant for the fulfilment of that milestone. As such, the Commission sees no reason to consider it as necessary for this element to be assessed, and disputes that this would be a basis for assessing that the milestone is not satisfactorily fulfilled.

In particular, the element identified by the ECA was always considered by Spain and the Commission as a medium-term objective. This is supported by the Spanish RRP itself (which explicitly refers to this as a medium-term objective) and the title of the reform in the Council Implementing Decision, which refers to the “short-term”, as well as the fact that the reform to the tax system to ensure a minimum corporate taxation was dealt with elsewhere in the RRP and Council Implementing Decision (C28.R3 and milestone 388) with different timelines.

This is also supported by the fact that the indicative schedule to complete this reform (31 March 2021) as per the Council Implementing Decision is previous to the date on which the OECD agreed on the measures to be implemented to attain this minimum 15% tax rate (8 October 2021). Based on the OECD agreement, the Commission published a proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union on 22 December 2021, for which there is no agreement in the Council.

The Commission also considers that the description of the milestone unequivocally mentions that the objective to be reached by the entry into force of the modifications introduced by the Budget Law for 2021 and the development regulations related to Corporate Income Tax is increasing corporate tax revenue. This is the short-term objective for this reform referred to in the Spanish RRP and was reached by the reform as reflected in Commission’s preliminary assessment. In view of the above, the Commission considers that attaining this minimum 15% tax rate was not relevant to the assessment of this milestone. Consequently, it was not mentioned in the Commission’s preliminary assessment of the milestone.

The Commission refers to its arguments on 10.24 and confirms that the minimum tax rate can only be interpreted as a mid-term objective. It considers, in light of the law being enacted prior to the adoption of the CID that it is evident that neither the Commission, nor Spain or the Council would have endorsed a milestone that was by definition unfulfillable. Accordingly, it is only expected that this issue is not referenced in the Member State’s documentation or the Commission’s assessment.

The amount a Member State is paid for satisfactorily fulfilling a given set of milestones and targets is established by the Council in the respective Council Implementing Decision. Payments
are made for satisfactorily fulfilling the relevant agreed milestones and targets. As a strictly performance-based instrument, the RRF links payments to performance and not to concretely incurred costs. The financial contribution under the RRF is determined on the basis of a maximum financial contribution calculated for each Member State and taking into account the estimated total costs of the RRP. In accordance with this *sui generis* concept, it is excluded to derive "the compensation for achieving an individual milestone or target".

The legal framework of the RRF Regulation requires the Commission to decide upon the amount of an instalment to suspend should only a subset of milestones and targets of a payment request be satisfactory fulfilled, and provides the Commission flexibility on deciding on the amount. The Commission has begun work to develop a methodology to provide equal treatment as regards to how the Commission applies this flexibility. Due to the RRF legal framework, such a methodology can, however, not be designed to derive "the compensation for achieving an individual milestone or target". The Commission is still developing this methodology, where it is noted that this was not needed in 2021, as the Commission assessed all milestones included in the first payment request submitted by Spain as satisfactorily fulfilled.

**Milestones related to the Member State’s control system**

**10.29** The Commission has clearly set out its assessment for each RRP, including on the control system criterion. All the approved RRPs include adequate control systems, where if the Commission had not considered the proposed control system as adequate, the plan would not have been assessed positively by the Commission.

The Commission highlights that where the CID leaves margin for interpretation, this does not cause risks for the Commission’s assessment of satisfactory fulfilment, but rather provides a margin for qualitative judgement.

**10.31-10.32** As regards milestone 173, the Commission confirmed through its work that the Spanish control system was able to meet the requirements of Article 22 of the RRF Regulation as it pertains to the elements covered by the milestone. In particular, the Commission assessed the completeness of the data collection systems and verified that 100% of the contracts were recorded appropriately.

The Commission considers that having identified areas that could be improved or made more efficient is not a good enough reason to put its assessment in question and thus could not justify rejecting the payment request and not making the payment. The Commission has to and will continue to identify areas for improvement when assessing milestones or targets on control and audit and share this with the Member States.

The Commission will continue to work with Member States, to improve the control systems used for the RRPs, whilst ensuring in its assessment that the legal minimum standards are maintained.

**Documentation of the assessment process**

**10.35** Concerning the two milestones mentioned in paragraph 10.35, the Commission considers that the evidence shared with the auditors fully demonstrates that it had the necessary documentation to support its findings, but acknowledges that improvements in record-keeping could be made in one case.

In relation to milestone 215, the Commission assessment was based on a thorough analysis of the content of the DATAESTUR website. The Commission has collected screenshots of the DATAESTUR website in October and November 2021 which prove the conclusions of Commission assessment.
Nonetheless, the Commission recognises that the registration of these screenshots did not take place in line with the internal guidance.

In relation to milestone 303, the Commission considers that it has kept the audit trail of the various exchanges with Spain and of the internal consultations between Commission services which support the conclusion of satisfactory fulfilment.

**ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS**

**10.41** The Commission considers that, in a context where payments are based on a qualitative assessment of the fulfilment of milestones and targets, where these milestones and targets do not have an individual value attributed to them and where these milestones and targets are very diverse, a meaningful error rate cannot be determined.

**10.42** The Commission notes that the RRF is not part of the MFF and that, as explained in its reply to paragraph 10.41, no meaningful error rate can be determined for the RRF, unlike for other funding programmes under the MFF - hence the separate statement in the AMPR. The Commission notes that the ECA is applying a similar approach in its Annual Report with a separate chapter for the RRF.

**CONCLUSION AND RECOMMENDATIONS**

**Conclusions**

**10.44** As explained in its reply to paragraph 10.27, based on the available evidence and its thorough ex-ante controls, the Commission does not agree with the conclusion of ECA and considers that the milestone was satisfactorily fulfilled. The Commission notes that the ECA considers on the basis of its professional judgement that the error is not material. In addition, as said in 10.41, the Commission considers that it is not possible to determine a meaningful error rate.

**10.45** As explained in its reply to paragraph 10.35, in one case the Commission was able to provide sufficient documentation but was not able to demonstrate its registration. In the other case, the Commission does not consider the documentation that ECA was seeking as being linked to the satisfactory fulfilment of the milestone or target.

**Recommendation 1 – Justify non-relevant elements for the assessment of milestones and targets**

The Commission partially accepts the recommendation.

Whilst the Commission accepts the recommendation as it pertains to the CID, as for the Operational Arrangements, the Commission will justify elements that are identified in the further specification of the milestones and targets. Other elements, such as monitoring steps, cannot by their nature be considered relevant and will not be justified on a case-by-case basis. The Commission additionally notes that the final decision as to what elements are not relevant is
subject to the opinion of the Economic and Financial Committee and the endorsement of Member States through the comitology process.

**Recommendation 2 – Develop a methodology for the (partial) suspension of a payment**

The Commission accepts the recommendation.

**Recommendation 3 – Improve documentation of the assessment of milestones and targets**

The Commission accepts the recommendation.
Annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds for the 2021 financial year
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>350</td>
</tr>
<tr>
<td>Chapter I Financial implementation of the 8th, 9th, 10th and 11th EDFs</td>
<td>353</td>
</tr>
<tr>
<td>Chapter II The ECA’s statement of assurance on the EDFs</td>
<td>356</td>
</tr>
<tr>
<td>European Commission's replies</td>
<td>381</td>
</tr>
</tbody>
</table>
Contents

Introduction 01-06
Brief description of the European Development Funds 02-06

Chapter I – Financial implementation of the 8th, 9th, 10th and 11th EDFs 07-10

Chapter II – The ECA’s statement of assurance on the EDFs 1.38
The ECA’s statement of assurance on the 8th, 9th, 10th and 11th EDFs to the European Parliament and the Council – independent auditor’s report 1.-XXI.
Information in support of the statement of assurance 11-38
Audit scope and approach 11-16
Reliability of accounts 17
Regularity of transactions 18-27
Annual activity report and other governance arrangements 28-38

Conclusion and recommendations 39-43
Conclusion 39-40
Recommendations 41-43

Annexes
Annex I – EDF payments in 2021 by main region
Annex II – Status of implementation of the action plans
Annex III – Follow-up of recommendations
Introduction

This annual report presents our findings on the 8th, 9th, 10th and 11th European Development Funds (EDFs). Figure 1 gives an overview of the activities and spending in this area in 2021.

Figure 1 – European Development Funds: 2021 financial overview

EDFs payments by budget line and type

(million euros)

<table>
<thead>
<tr>
<th>Budget support</th>
<th>Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>11th</td>
<td>2 746</td>
</tr>
<tr>
<td>10th</td>
<td>311</td>
</tr>
<tr>
<td>9th</td>
<td>8</td>
</tr>
</tbody>
</table>

EDFs payments and audited population

(million euros)

<table>
<thead>
<tr>
<th>Payments 3 401</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prefinancing payments (*) 2 020</td>
</tr>
<tr>
<td>Interim/final payments 747</td>
</tr>
<tr>
<td>Trust fund contributions 634</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit population 3 145</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clearing of prefinancing (*) 1 788</td>
</tr>
<tr>
<td>Trust fund disbursements 610</td>
</tr>
</tbody>
</table>

(*) In line with the harmonised definition of underlying transactions (for details see Annex 1.1, paragraph 12).

Source: ECA, based on the 2021 annual accounts of the 8th, 9th, 10th and 11th EDFs.
Brief description of the European Development Funds

02 Launched in 1959, the EDFs were the main instruments by which the European Union (EU) provided development cooperation aid to the African, Caribbean and Pacific (ACP) countries and overseas countries and territories (OCTs) until the end of 2020, with the 11th (and final) EDF covering the 2014-2020 multiannual financial framework (MFF). The framework governing the EU’s relations with ACP countries and OCTs was a partnership agreement signed in Cotonou (‘the Cotonou Agreement’) on 23 June 2000 for a period of 20 years. The application of its provisions has been extended, currently until 30 June 2022. Its primary objective was to reduce and ultimately eradicate poverty, in accordance with the primary objective of development cooperation as laid down in Article 208 of the Treaty on the Functioning of the European Union (TFEU). For the 2021-2027 multiannual financial framework (MFF), development cooperation aid to ACP countries has been incorporated into the Neighbourhood, Development and International Cooperation Instrument – Global Europe (‘NDICI-Global Europe’) and development cooperation aid to the OCTs has been incorporated into the Decision on the Overseas Association, including Greenland. However, the 8th, 9th, 10th and 11th EDFs themselves were not incorporated into the EU general budget and continue to be implemented and reported on separately until their closure.

03 In 2019, the Commission closed the remaining outstanding transactions for 8th EDF projects. All balances and decommitments have been transferred to the 9th EDF. In 2021, it announced the financial and operational closure of the 8th EDF. All related activities have been completed, all checks and controls have been performed, and all contracts and financial decisions are closed in the EDF accounts.
The EDFs are particular in that:

(a) they were directly financed by the Member States’ contributions based on quotas, or ‘contribution keys’, which were set by the national governments at the Council of the European Union in subsequent internal agreements concluded between the representatives of EU Member States meeting within the Council;

(b) they are managed by the Commission, outside the framework of the EU general budget, and the European Investment Bank (EIB);

(c) due to the intergovernmental nature of the EDFs, the European Parliament plays a more limited role in their functioning than it does for the development cooperation instruments financed by the EU general budget; notably, it was not involved in establishing and allocating EDF resources. However, the European Parliament is the discharge authority, except for the Investment Facility, which is managed by the EIB and is therefore outside the scope of our audit1 2;

(d) the principle of annuality does not apply to the EDFs: EDF agreements were usually concluded for a commitment period of five to seven years, and payments can be made over a much longer time frame.

The EDFs are managed almost entirely by the Commission’s Directorate-General for International Partnerships (DG INTPA)3. A small proportion (0.25 %) of the 2021 EDF expenditure was managed by the Directorate-General for Humanitarian Aid and Civil Protection (DG ECHO).

The expenditure covered in this report is delivered in 79 countries using a wide range of methods such as works, supply and service contracts, grants, budget support, programme estimates and contribution and delegation agreements concluded with pillar-assessed entities (e.g. international organisations) (see Annex I).

---

1 See Articles 43, 48-50 and 58 of Regulation (EU) 2015/323 on the financial regulation applicable to the 11th European Development Fund.

2 In 2012, a tripartite agreement between the EIB, the Commission and the ECA (Article 134 of Regulation (EC) No 215/2008 on the Financial Regulation applicable to the 10th EDF) set out the rules for the audit of these operations by the ECA.

3 DG DEVCO became DG INTPA in January 2021.
Chapter I – Financial implementation of the 8th, 9th, 10th and 11th EDFs

07 The budget of the 8th EDF (1995-2000) was €12.8 billion, that of the 9th EDF (2000-2007) €13.8 billion, and that of the 10th EDF (2008-2013) €22.7 billion.

08 The internal agreement establishing the 11th EDF (2015-2020) came into force on 1 March 2015. Between 2013 and 2015, funds were committed via a bridging facility to ensure continuity pending ratification of the 11th EDF. The 11th EDF holds €30.5 billion, of which €29.1 billion has been allocated to the ACP countries and €0.4 billion to the OCTs, with €1.1 billion for administrative costs.

09 Figure 2 shows the use of EDF resources both in 2021 and cumulatively for the 8th, 9th, 10th and 11th EDFs.
Figure 2 – Use of EDF resources at 31 December 2021*

<table>
<thead>
<tr>
<th>A – RESOURCES$1</th>
<th>Budgetary implementation during the 2021 financial year (net)$2</th>
<th>B – USE</th>
<th>Situation at end of 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total amount</td>
<td>8$\text{th}$ EDF</td>
<td>9$\text{th}$ EDF</td>
<td>10$\text{th}$ EDF</td>
</tr>
<tr>
<td>75,959</td>
<td>0</td>
<td>-14</td>
<td>-113</td>
</tr>
<tr>
<td>Situation at end of 2020</td>
<td>Budgetary implementation during the 2021 financial year (net)</td>
<td>8$\text{th}$ EDF</td>
<td>9$\text{th}$ EDF</td>
</tr>
<tr>
<td>1. Global commitments$4</td>
<td>75,929</td>
<td>100.0%</td>
<td>0</td>
</tr>
<tr>
<td>2. Individual commitments$6</td>
<td>71,304</td>
<td>93.9%</td>
<td>0</td>
</tr>
<tr>
<td>3. Payments</td>
<td>62,018</td>
<td>81.6%</td>
<td>0</td>
</tr>
<tr>
<td>C – Outstanding commitments (B1-B3)</td>
<td>13,911</td>
<td>18.3%</td>
<td>0</td>
</tr>
<tr>
<td>D – Available balance (A-B1)$7</td>
<td>30</td>
<td>0.0%</td>
<td>0</td>
</tr>
</tbody>
</table>

* Rounded figures.
$1 Include initial allocations to the 8$\text{th}$, 9$\text{th}$, 10$\text{th}$ and 11$\text{th}$ EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.
$2$ As a percentage of resources.
$3$ Negative amounts correspond to decommitments.
$4$ Global commitments relate to financing decisions.
$5$ Individual commitments relate to individual contracts.
$6$ Net commitments after decommitments. Net payments after recoveries.
$7$ Balance available includes ‘non-mobilisable reserve’ (unusable without unanimous decision from the Council).

Source: ECA, based on the 2021 annual accounts of the 8$\text{th}$, 9$\text{th}$, 10$\text{th}$ and 11$\text{th}$ EDFs. The figures presented do not cover the EDF part managed by the EIB.
Every year, DG INTPA sets itself key performance indicators (KPIs) on sound financial management and the efficient use of resources. These indicators show that, in 2021, despite the difficulties related to the COVID-19 crisis, DG INTPA reached its targets of reducing old pre-financing and unspent commitments by 35 % compared to 2020 and keeping the proportion of open expired contracts (i.e. those not closed after the end of their operational activities) in its portfolio below 15 %. This was the result of an improvement in procedures in recent years (see Box 1). Both targets comprised an overall target for DG INTPA’s entire area of responsibility and a specific target for the EDFs.

**Box 1**

**KPIs on reducing old pre-financing, unspent commitments and percentage of open expired contracts**

In 2021, DG INTPA maintained the previous year’s target of 35 % for its KPIs on reducing old pre-financing (KPI 10) and unspent commitments (KPI 12). It exceeded these targets for both indicators, significantly reducing old pre-financing for both the EDF (46 %) and its entire area of responsibility (50 %). It reduced unspent commitments by 39 %, both for the EDF and across its entire area of responsibility.

DG INTPA also reached its target of having no more than 15 % of expired contracts still open in the system (KPI 11), both for the EDF (13 %) and across its entire area of responsibility (10 %). The KPI for the EDF has consistently improved since 2017 (19 % in 2017, 17 % in 2018, 15 % in 2019 and 14 % in 2020) as a result of the new procedures established in 2017.
Chapter II – The ECA’s statement of assurance on the EDFs

The ECA’s statement of assurance on the 8th, 9th, 10th and 11th EDFs to the European Parliament and the Council – independent auditor’s report

Opinion

I. We have audited:

(a) the annual accounts of the 8th, 9th, 10th and 11th EDFs, which comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets and the report on financial implementation for the financial year ended 31 December 2021, approved;

(b) the legality and regularity of the underlying transactions of which financial management falls to the Commission⁴.

Reliability of the accounts

Opinion on the reliability of the accounts

II. In our opinion, the annual accounts of the 8th, 9th, 10th and 11th EDFs for the year ended 31 December 2021 present fairly, in all material respects, their financial position as at 31 December 2021, the results of their operations, their cash flows and the changes in their net assets for the year then ended, in accordance with the EDF Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

⁴ Pursuant to Articles 43, 48-50 and 58 of the Financial Regulation applicable to the 11th EDF, this statement of assurance does not extend to the EDF resources managed by the EIB.
Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue

III. In our opinion, the revenue underlying the accounts for the year ended 31 December 2021 is legal and regular in all material respects.

Expenditure

Adverse opinion on the legality and regularity of expenditure

IV. In our opinion, owing to the significance of the matter described under ‘Basis for adverse opinion on the legality and regularity of expenditure’, the expenditure accepted in the accounts for the year ended 31 December 2021 is materially affected by error.

Basis for Opinion

V. We have conducted our audit in accordance with the IFAC International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under these standards and codes are described in more detail in the ‘Auditor’s responsibilities’ section of our report. We have also met independence requirements and fulfilled our ethical obligations under the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Basis for adverse opinion on the legality and regularity of expenditure

VI. The expenditure recorded in 2021 under the 8th, 9th, 10th and 11th EDFs is materially affected by error. Our estimated level of error for expenditure accepted in the accounts is 4.6%.

Key audit matters

VII. Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters.
Accrued charges

VIII. We assessed the accrued charges presented in the accounts which are subject to a high degree of estimation. At year-end 2021, the Commission estimated that eligible expenses incurred but not yet reported by beneficiaries amounted to €5 381 million (year-end 2020: €5 452 million).

IX. We examined the calculation of these accrual estimates and reviewed a sample of 30 individual pre-financings and 27 invoices in step 1 to address the risk that the accrual was misstated. The work performed led us to conclude that the accrued charges recognised in the final accounts were appropriate.

Potential impact on the 2021 EDF accounts of the United Kingdom’s withdrawal from the European Union

X. On 1 February 2020, the United Kingdom (UK) ceased to be an EU Member State. Following the conclusion of the agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (the ‘Withdrawal Agreement’) between the two parties, the UK committed to remain party to the EDF until the closure of the 11th EDF and all previous unclosed EDFs. The UK will assume the same obligations as the Member States under the internal agreement by which the 11th EDF was set up, as well as the obligations arising from previous EDFs until their closure.

XI. The Withdrawal Agreement also states that, where the amounts from projects under the 10th EDF or from previous EDFs have not been committed or have been decommitted on the date of entry into force of this agreement, the UK’s share of those amounts will not be reused. The same applies to the UK’s share of funds not committed or decommitted under the 11th EDF after 31 December 2021.

XII. Based on this, there is no financial impact to report on the 2021 EDF accounts. We conclude that the EDF accounts as at 31 December 2021 correctly reflect the state of the withdrawal process at that date.

Responsibilities of management

XIII. In accordance with Articles 310 to 325 of the TFEU and with the 11th EDF Financial Regulation, management is responsible for preparing and presenting the EDF annual accounts on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or
error. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EDF accounts.

**XIV.** When preparing the EDF accounts, the Commission is responsible for assessing the EDFs’ ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

**XV.** The Commission is responsible for overseeing the EDFs’ financial reporting process.

**Auditor’s responsibilities for the audit of the EDF accounts and underlying transactions**

**XVI.** Our objectives are to obtain reasonable assurance as to whether the EDF accounts are free from material misstatement and the underlying transactions are legal and regular, and to provide, on the basis of our audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of a material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence any economic decisions taken on the basis of these EDF accounts.

**XVII.** As part of an audit in accordance with ISAs and ISSAIs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the EDF accounts and of material non-compliance of the underlying transactions with the requirements of the EDF legal framework, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

- Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the internal control.
o Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management’s accounting estimates and related disclosures.

o Conclude as to the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the EDFs’ ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the EDF accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.

o Evaluate the overall presentation, structure and content of the annual accounts, including all disclosures, and assess whether the annual accounts fairly represent the underlying transactions and events.

XVIII. We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including findings of any significant deficiencies in internal control.

XIX. For revenue, we examine all contributions from Member States and a sample of other types of revenue transactions.

XX. For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (other than advances) at the point they are made. Advance payments are examined once the recipient of funds has provided evidence of their proper use and the institution or body has accepted that evidence by clearing the advance payment, which might not happen until a subsequent year.

XXI. Of the matters discussed with the Commission, we determine which were of most significance in the audit of the EDF accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report
because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

7 July 2022

Klaus-Heiner LEHNE
President

European Court of Auditors
12, rue Alcide De Gasperi – L-1615 Luxembourg

Information in support of the statement of assurance

Audit scope and approach

11 Annex 1.1 to our 2021 annual report on the implementation of the EU budget sets out our audit approach and methods, which also apply to the audit of the EDF.

12 Our observations on the reliability of the EDF accounts are based on the financial statements\(^5\) of the 8\(^{th}\), 9\(^{th}\), 10\(^{th}\) and 11\(^{th}\) EDFs, approved by the Commission\(^6\), together with the accounting officer’s letter of representation received on 28 June 2022. We tested amounts and disclosures and assessed the accounting principles used, as well as any significant estimates made by the Commission and the overall presentation of the accounts.

---

\(^5\) See Article 39 of Regulation (EU) 2018/1877 on the financial regulation applicable to the 11\(^{th}\) European Development Fund.

\(^6\) In compliance with the EDF Financial Regulation; see Article 38 of Regulation (EU) 2018/1877.
To audit the regularity of transactions, we examined a sample of 140 transactions that were representative of the full range of spending from the EDFs. This comprised 26 transactions related to the Emergency Trust Fund for Africa, 92 transactions authorised by 17 EU delegations\(^7\) and 22 payments approved by Commission headquarters\(^8\). Where we detected errors in the transactions, we analysed the underlying causes to identify potential weaknesses.

We also examined the following for 2021:

(a) all Member State contributions and a sample of other types of revenue transactions, such as other countries’ co-financing contributions;

(b) certain systems used by DG INTPA and the EU delegations, covering: (i) *ex ante* checks by Commission staff and external auditors (contracted by the Commission or the beneficiaries) before payments were made, (ii) monitoring and supervision, notably the follow-up of external audits and the RER study;

(c) the reliability of the regularity information in the annual activity report (AAR) of DG INTPA, the consistency of the methodology for estimating amounts at risk, future corrections and recoveries and their inclusion in the Commission’s Annual Management and Performance Report (AMPR);

(d) the follow-up of our previous recommendations.

As stated in paragraph 05, DG INTPA implements most of the external aid instruments financed from both the EU general budget and the EDFs. Our observations on systems and the presentation of information in the AAR refer to DG INTPA’s entire area of responsibility, not just the EDFs.

---

\(^7\) Botswana, Burkina Faso, Djibouti, Timor-Leste, Ethiopia, Ghana, Guinea-Bissau, Haiti, Jamaica, Liberia, Malawi, Mali, Niger, Nigeria, Tanzania, Uganda and Zambia.

\(^8\) All 140 payments were through DG INTPA.
Due to the COVID-19 pandemic, it was not possible to carry out on-the-spot visits to EU delegations, which we replaced with desk reviews. This prevented us from carrying out certain audit procedures, and particularly from verifying contract performance for the transactions selected, thus limiting our audit work. We had to adapt our approach, carrying out desk reviews of transactions and projects and liaising remotely with our auditees. Not carrying out on-the-spot checks may increase detection risk; nevertheless, we consider that the evidence obtained enabled us to complete and conclude on our work.

Reliability of accounts

Our audit found that the accounts were not affected by material misstatements.

Regularity of transactions

Revenue

Revenue transactions did not contain a material level of error.

Expenditure

Of the 140 transactions we examined, 54 (38.8%) contained errors. On the basis of the 43 errors we have quantified, we estimate the level of error to be 4.6% (see Figure 3).

---


10 Detection risk is the risk that the auditor will not detect a deviation that has not been corrected by the entity’s internal controls.
Figure 3 – Results of transaction testing

Estimated impact of quantifiable errors

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materiality</td>
<td>2.0%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Estimated level of error</td>
<td>3.8%</td>
<td>4.6%</td>
</tr>
<tr>
<td>6.7% Upper error limit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5% Lower error limit</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sample size

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>140 transactions</td>
<td>140 transactions</td>
<td></td>
</tr>
</tbody>
</table>

Source: ECA.

20 Figure 4 gives a breakdown of our estimated level of error for 2021 by error type.

Figure 4 – Breakdown of estimated level of error by error type

- Ineligible expenditure: 38.6%
- Absence of essential supporting documents: 23.3%
- Expenditure not incurred: 14.9%
- Serious failure to respect public procurement rules: 14.6%
- Other types of error: 8.6%

Source: ECA.
Box 2 presents examples of errors we quantified, likewise by error type.

Absence of legal basis resulting in ineligible expenditure

The Commission signed a grant contract with an international organisation to improve Niger’s cash management function and implement a treasury single account in the country. The total cost of the action was estimated at €1.4 million, with an EU contribution of 100%.

We reviewed the financing agreement, worth €82 million, signed between the Commission and Niger. It stated that the funds were to be spent on budget support and other projects, but contained no mention of work to be done on a treasury single account. The financing agreement also did not provide for the award of any related contract to the organisation concerned or to any other body, despite being cited as the legal basis for the award in question. The entire value of the contract (€1.4 million) is affected by error.

Absence of essential supporting documents

The Commission concluded a delegation agreement worth €16 million (99.75 % EU-funded) with an international organisation to encourage private-sector investment in Ugandan commercial timber plantations by offering grants and technical support.

One of the transactions selected for audit concerned an employee’s salary costs of €9 000 for work done on the project. The employment contract allocated this employee to work on projects other than the one audited.

The international organisation was unable to provide proof that the employee had worked on the project audited. We therefore consider the expenditure ineligible.
Part of expenditure not incurred resulting in ineligible costs charged to the project

The Commission signed a delegation agreement with an international organisation to support and facilitate access to education for vulnerable children. The total cost of the action was estimated at €24.5 million, of which the EU covered €19.5 million (79.6 %).

While examining the expenditure breakdown, we noticed that the international organisation had declared – and the Commission had cleared – expenditure of €7.4 million. Our checks revealed that the real expenditure for the period was €6.9 million. The difference of €0.5 million represented the amount committed by the organisation but not yet spent. The Commission had therefore incorrectly cleared 6.2 % of the audited amount.

Serious failure to respect public procurement rules: unjustified decisions of the national authorising officer

Mali’s EDF national authorising officer (NAO) awarded a contract to a consultancy company for the provision of technical assistance to improve road maintenance in the country. This assistance was financed from the 11th EDF and had a value of €1.2 million.

The NAO used a restricted call for tenders to procure the services. Two tenderers reached the final evaluation stage. The first tenderer obtained the best score based on the ‘best value for money’ criterion but was rejected by the NAO based on the recommendation of the evaluation committee, which considered its bid abnormally low (€1 million, the ceiling for the contract being €1.2 million). The NAO awarded the contract to the second tenderer.

The first tenderer made two appeals to Mali’s dispute settlement committee, which found its arguments valid and ordered the NAO to overturn the original decision. However, the NAO refused to do so.

The award of this contract was therefore unjustified, and its entire value is affected by error.

22 As they did in 2020, the Commission and its implementing partners committed more errors in transactions relating to grants and to contribution and delegation agreements with beneficiary countries, international organisations and Member State agencies than they did with other forms of support (such as those covering works, supply and service contracts). Of the 92 transactions of this type that we examined, 39 contained quantifiable errors, which accounted for 81 % of the estimated level of error.
In 15 cases of quantifiable error and eight cases of non-quantifiable error, the Commission had sufficient information to prevent, or to detect and correct, the error before accepting the expenditure. Had the Commission made proper use of all the information at its disposal, the estimated level of error would have been 2.4 percentage points lower.

Moreover, 25 transactions containing quantifiable errors, contributing 1.9 percentage points to the estimated level of error, were subject to an audit or expenditure verification. DG INTPA’s control system is based on \textit{ex ante} checks\textsuperscript{11}. The information provided in the audit/verification reports describing the work actually done did not allow us to assess whether the errors could have been detected and corrected during these \textit{ex ante} checks\textsuperscript{12}.

As in previous years, the frequency of the errors found – including some contained in final claims which had been subjected to \textit{ex ante} external audits and expenditure verifications – points to weaknesses in these checks.

We identified two spending areas where transactions are less prone to errors due to specific payment conditions. These areas are (i) budget support and (ii) multi-donor projects implemented by international organisations and subject to the ‘notional approach’. In 2021, we audited four budget support transactions and eight ‘notional approach’ projects managed by international organisations\textsuperscript{13}.

\begin{itemize}
\item \textsuperscript{11} The overall control system consists of \textit{ex ante} and \textit{ex post} checks. \textit{Ex ante} checks assess the eligibility of the expenditure prior to contracting and prior to accepting the expenditure, whereas \textit{ex post} checks take place after expenditure has been accepted. For example, an external audit can be done either \textit{ex ante} (before accepting a payment) or \textit{ex post} (after a project has been completed). Both types can result in the recovery of funds paid to the beneficiary; in the case of \textit{ex ante} checks, such recoveries concern pre-financing previously paid.
\item \textsuperscript{12} The reports do not cover 100\% of the reported expenditure; nor do they give sufficient detail to confirm whether the items where we identified errors had been part of their sample.
\item \textsuperscript{13} Paragraphs \textbf{8.10-8.12} in \textbf{chapter 8} of our 2021 annual report on the implementation of the budget give more details on budget support and the notional approach.
\end{itemize}
27 As in previous years, some international organisations provided only limited access to documents (e.g. in read-only format), meaning we could not make copies of them. These issues hindered the planning and execution of our audit and led to delays in the audit team receiving the requested documentation and carrying out its work. We made related recommendations in our 2018 and 2020 annual reports. Although the Commission has stepped up its communication with international organisations, we continue to have difficulties with some of them in obtaining the requested documentation.

Annual activity report and other governance arrangements

28 In every annual activity report from 2012 to 2018, DG INTPA issued reservations on the regularity of underlying transactions. It did not issue reservations in 2019, 2020 or 2021. Nevertheless, as it had done in previous years, it adopted action plans to address the weaknesses in the implementation of its control system.

29 In 2019 and 2020, we reported on the satisfactory progress achieved on the 2018 and 2019 action plans; by April 2021, out of nine actions, seven had been completed and two were ongoing. In the 2020 action plan, DG INTPA, as in previous years, adjusted the number of actions, this time to seven. Five of these actions were carried over from previous years and two new actions were added: (i) reducing excess clearing of pre-financing and (ii) conducting an evaluation on the use of the new terms of reference for expenditure verifications. By April 2022, four actions had been completed and three were ongoing.

30 For the 2021 action plan, one new action was added: addressing the high-risk observations from the audit by the Commission’s Internal Audit Service (IAS) on pillar assessment in the ‘external action family’ (DG BUDG, DG ECHO, DG INTPA, DG NEAR and FPI as the DGs and services responsible for external action). Two of the seven other actions are continuous and the other five were carried over (see Annex II).

2021 RER study

31 In 2021, DG INTPA had its tenth residual error rate (RER) study carried out by an external contractor on its behalf. The purpose of the study is to estimate the rate of those errors that have evaded all DG INTPA management checks to prevent, detect and correct such errors across its entire area of responsibility, in order to conclude on the effectiveness of those checks. It is an important element for the Director-General’s declaration of assurance, and feeds into the regularity information on external action disclosed in the AMPR.
For the 2021 RER study, DG INTPA applied a sample size of 480\textsuperscript{14} transactions (exactly the same as in 2020 and 2019). This allowed it to once again present separate error rates for expenditure financed from the EU general budget and for spending financed by the EDF, in addition to the overall error rate for both combined. For the sixth year in a row, the study estimated the overall RER to be below the 2 \% \textit{materiality threshold} set by the Commission 2021: 1.14 \%.

The RER study does not constitute an \textit{assurance engagement} or an audit; it is based on the RER methodology and manual provided by DG INTPA. Our previous annual reports\textsuperscript{15} on the EDFs have already described limitations in the studies that may have contributed to the RER’s underestimation.

One aspect of the RER study is the degree of reliance placed on the work of other auditors. Three scenarios are possible: (i) no reliance on the work of other auditors with full substantive testing; (ii) partial reliance on the work of other auditors with reduced substantive testing; (iii) full reliance on the work of other auditors with no further testing. Full reliance increased from 15 \% of transactions in 2020 to 34 \% of transactions in 2021. We maintain our view that placing such extensive reliance on the work of other auditors is contrary to the purpose of an RER study which is to estimate the rate of errors that have evaded all DG INTPA management checks to prevent, detect and correct such errors.

\textsuperscript{14} Some of the sampled transactions have a value higher than the \textit{sampling interval}; therefore, the final sample size was 412.

\textsuperscript{15} See our 2017, 2018, 2019 and 2020 annual reports on the EDFs.
Review of the 2021 AAR

35 The Director-General’s declaration of assurance in the 2021 AAR does not include any reservations. From 2018, DG INTPA significantly reduced the scope of reservations (i.e. the share of expenditure covered by them). Figure 5 shows the scope of reservations presented in the AARs each year from 2011 to 2021.

Figure 5 – DG INTPA AAR reservations 2011-2021

![Annual expenditure subject to a reservation in the AAR (% share)](image)

Source: ECA.

36 We find the lack of reservations in the 2021 AAR unjustified and consider that it results partly from the limitations of the RER study, given that our findings on this study also concern the estimates of amounts at risk based thereupon. DG INTPA estimates the overall amount at risk at payment to be €79.65 million\(^{16}\) (1.41 % of 2021 expenditure) and the overall amount at risk at closure to be €66.03 million\(^ {17}\). Of the amount at risk at payment, DG INTPA estimates that €13.62 million (24 %) will be corrected by its checks in subsequent years (this amount is known as the ‘corrective capacity’).

\(^{16}\) This is the Commission’s best conservative estimate of the amount of relevant expenditure incurred during the year that was not compliant with the contractual and regulatory provisions applicable at the time payment was made.

\(^{17}\) See DG INTPA’s 2021 AAR, p. 34.
DG INTPA is working to improve the quality of its data for calculating the corrective capacity. In 2021, it continued its training and awareness-raising activities on recoveries and accounting data quality. As in previous years, DG INTPA performed targeted checks on recovery orders to correct the discrepancies identified. We reviewed the calculation of the corrective capacity for 2021. Having tested 35% (by value) of the total population of recoveries, we identified no errors in our sample.

In order to make financial reporting more consistent across Commission DGs, a ‘financial scorecard’ was created in 2020, comprising six indicators. Four more were added in 2021. Six of these ten indicators were applicable to the EDF and the trust funds in 2021. For ‘global commitment absorption’, DG INTPA achieved a result of 99% for the EU budget and 97% for the EDF in 2021, compared to 95% and 94% respectively in 2020. For ‘timely payments’, DG INTPA achieved 97% for the EU budget and 95% for the EDF in 2021, compared to 98% and 97% respectively in 2020.

---

18 Specific training local staff of the EU delegations on guidelines for entering recovery orders.

19 The financial scorecard is a set of six standard financial indicators for the European Commission as a whole. Its purpose is to benchmark each Commission DG and service. The indicators are: 1) implementation of commitment appropriations, 2) implementation of commitment appropriation forecasts, 3) implementation of payment appropriations, 4) implementation of payment appropriation forecasts, 5) global commitment absorption, 6) timely payments.

20 The four additional indicators are: 7) timely decommitments, 8) invoice registration time, 9) accounting data quality, 10) management data quality.
Conclusion and recommendations

Conclusion

39 The overall audit evidence indicates that the EDFs’ accounts for the financial year ending 31 December 2021 present fairly, in all material respects, their financial position, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the accounting officer.

40 The overall audit evidence indicates that, for the financial year ending 31 December 2021:

(a) the revenue of the EDFs was not affected by a material level of error;

(b) EDF payment transactions were affected by a material level of error (see paragraphs 19-25). We estimate the level of error to be 4.6 % based on our transaction testing.

Recommendations

41 Annex III shows the findings of our follow-up review of the two recommendations we made in our 2018 annual report on the EDFs, of which DG INTPA had implemented21 one recommendation in most respects and one in some respects.

42 We also reviewed recommendations from our 2019 and 2020 annual reports on the EDFs that required immediate action or were targeted for implementation during 2021 (see Annex III). For both 2019 and 2020, we consider two of the recommendations implemented in some respects and one not yet implemented.

43 Based on this review and our findings and conclusions for 2021, we recommend that the Commission (see Box 2):

---

21 The aim of this follow-up was to verify whether corrective measures had been taken in response to our recommendations, and not to assess the effectiveness of their implementation.
Recommendation 1 – Strengthen controls in respect of legal bases before signing contracts

Strengthen internal control to ensure that no contracts are signed without the existence of a valid legal basis.

Target implementation date: End of 2023.

Recommendation 2 – Deduct costs not incurred before payment or clearing

Take appropriate measures aimed at ensuring that any commitments or advance payments claimed as incurred costs by beneficiaries in their financial reports are deducted before carrying out payments or clearings.

Target implementation date: End of 2023.
Annexes

Annex I – EDF payments in 2021 by main region

European Development Fund Payments – Africa

<table>
<thead>
<tr>
<th>Beneficiary Countries</th>
<th>Top 10 (million euros)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Somalia</td>
<td>219</td>
</tr>
<tr>
<td>2. Democratic Republic of the Congo</td>
<td>109</td>
</tr>
<tr>
<td>3. Tanzania</td>
<td>101</td>
</tr>
<tr>
<td>4. Uganda</td>
<td>84</td>
</tr>
<tr>
<td>5. Niger</td>
<td>81</td>
</tr>
<tr>
<td>6. Malawi</td>
<td>79</td>
</tr>
<tr>
<td>7. Mozambique</td>
<td>74</td>
</tr>
<tr>
<td>8. Sudan</td>
<td>70</td>
</tr>
<tr>
<td>9. Nigeria</td>
<td>66</td>
</tr>
<tr>
<td>10. Kenya</td>
<td>65</td>
</tr>
</tbody>
</table>

Source: Created with “Tableau” by ECA, map background © Mapbox and © OpenStreetMap licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA).
European Development Fund Payments – Caribbean and Pacific

<table>
<thead>
<tr>
<th>Beneficiary Countries</th>
<th>Top 5 (million euros)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Haiti</td>
<td>47</td>
</tr>
<tr>
<td>2. Jamaica</td>
<td>11</td>
</tr>
<tr>
<td>3. Guyana</td>
<td>8</td>
</tr>
<tr>
<td>4. Belize</td>
<td>7</td>
</tr>
<tr>
<td>5. Dominican Republic</td>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Beneficiary Countries</th>
<th>Top 5 (million euros)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Papua New Guinea</td>
<td>29</td>
</tr>
<tr>
<td>2. Timor-Leste</td>
<td>9</td>
</tr>
<tr>
<td>3. Vanuatu</td>
<td>6</td>
</tr>
<tr>
<td>4. Fiji</td>
<td>5</td>
</tr>
<tr>
<td>5. Marshall Islands</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Created with “Tableau” by ECA, map background © Mapbox and © OpenStreetMap licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA).
### Annex II – Status of implementation of the action plans

<table>
<thead>
<tr>
<th>Action Plan 2019</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1 Simplify and clarify procedures and contractual conditions for grants.</td>
<td>Ongoing</td>
</tr>
<tr>
<td>A.2 Maintain awareness on frequently occurring errors in financial and document management for the implementation of grant contracts.</td>
<td>Implemented</td>
</tr>
<tr>
<td>B.1 Develop a strategy for the reduction of the use of the Programme Estimate and promotion of alternatives, in view of simplification and cost-effectiveness.</td>
<td>Implemented</td>
</tr>
<tr>
<td>C.1 Work towards use of ToR for Expenditure Verifications adopted (Ares (2018) 1722717) in 2017 for verification of expenditure incurred by IOs under indirect management.</td>
<td>Implemented</td>
</tr>
<tr>
<td>C.2 Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.</td>
<td>Implemented</td>
</tr>
<tr>
<td>D.1 Increase consistency and coherence of the functioning of audit and verification tasks.</td>
<td>Implemented</td>
</tr>
<tr>
<td>D.2 Clarify and promote use of simplified cost options.</td>
<td>Implemented</td>
</tr>
<tr>
<td>D.3 Clarify and promote use of results-based financing.</td>
<td>Ongoing</td>
</tr>
<tr>
<td>D.4 Improve the methodology and manual of the RER study (new action 2019).</td>
<td>Implemented</td>
</tr>
<tr>
<td></td>
<td><strong>Action Plan 2020</strong></td>
</tr>
<tr>
<td>---</td>
<td>---------------------</td>
</tr>
<tr>
<td>A.1</td>
<td>Simplify and clarify procedures and contractual conditions for grants.</td>
</tr>
<tr>
<td>A.2</td>
<td>Maintain awareness on frequently occurring errors in financial and document management for the implementation of grant contracts.</td>
</tr>
<tr>
<td>B.1</td>
<td>Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.</td>
</tr>
<tr>
<td>C.1</td>
<td>Clarify and promote use of results-based financing.</td>
</tr>
<tr>
<td>C.2</td>
<td>Improve the methodology and manual of the RER study (new action build on AP 2019/D4).</td>
</tr>
<tr>
<td>C.3</td>
<td>Reduce excess clearing of pre-financing (new action).</td>
</tr>
<tr>
<td>C.4</td>
<td>Conduct an evaluation on the use of ToR for Expenditure Verifications (EV) (new action).</td>
</tr>
<tr>
<td>Action Plan 2021</td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td></td>
</tr>
<tr>
<td>A.1 Simplify and clarify procedures and contractual conditions for grants.</td>
<td>Ongoing</td>
</tr>
<tr>
<td>B.1 Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.</td>
<td>Implemented</td>
</tr>
<tr>
<td>B.2 Address the high-risk observations from the IAS audit on pillar assessment of external actions (new action).</td>
<td>Implemented</td>
</tr>
<tr>
<td>C.1 Clarify and promote use of results-based financing.</td>
<td>Ongoing</td>
</tr>
<tr>
<td>C.2 Improve the methodology and manual of the RER study (new action build on AP 2019/D4).</td>
<td>Implemented</td>
</tr>
<tr>
<td>C.3 Address vulnerabilities to excess clearing of prefinancing.</td>
<td>Ongoing</td>
</tr>
<tr>
<td>C.4 Conduct an evaluation on the use of ToR for Expenditure Verifications (EV).</td>
<td>Implemented</td>
</tr>
<tr>
<td>C.5 Share information on frequently occurring errors with relevant control stakeholders (new action).</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>

## Annex III – Follow-up of recommendations

<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>Recommendation 1:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Take steps to reinforce the obligation on international organisations to forward to the ECA, at its request, any document or information necessary to carry out its task as foreseen in the TFEU.</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>Recommendation 2:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Improve the RER study’s methodology and manual so that they give more comprehensive guidance on the issues we have identified in this report and, therefore provide appropriate support for DG DEVCO’s risk assessment for the reservations.</td>
<td></td>
</tr>
</tbody>
</table>

---

<sup>22</sup> The Commission intensified communication with international organisations regarding our access to documents. Some organisations, such as the World Bank Group (WBG), improved their cooperation with us, but others did not. Some United Nations (UN) organisations, such as the United Nations Children’s Fund (UNICEF), the International Office of Migration (IOM) and the United Nations Development Programme (UNDP), continue to provide read-only access to supporting documentation.
<table>
<thead>
<tr>
<th>Year</th>
<th>ECA recommendation</th>
<th>ECA’s analysis of the progress made</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Fully implemented</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 2019 | **Recommendation 1:**  
Further improve the methodology and manual used for the RER study to address the issues we have identified in this report, in order to make the error rate reported in the study more reliable.  
Timeframe: by the end of 2021. | | | X | | |
| 2020 | **Recommendation 1:**  
Take steps so that international organisations provide the ECA with complete, unlimited and timely access to documents necessary to carry out its task in accordance with the TFEU, and not just in read-only format.  
Timeframe: by the end of 2021. | | | **X**<sup>23</sup> | | |
|      | **Recommendation 2:**  
Issue reservations for all areas found to have a high level of risk, regardless of their share of total expenditure and their financial impact.  
Timeframe: by the time the 2021 AAR is published. | | | | | X |

*Source: ECA.*

<sup>23</sup> See recommendation 1 from 2018.
European Commission’s replies to the annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds for the 2021 financial year
REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS’ 2021 ANNUAL REPORT

“ANNUAL REPORT ON THE ACTIVITIES FUNDED BY THE 8TH, 9th, 10th AND 11th EUROPEAN DEVELOPMENT FUNDS”

INTRODUCTION TO THE COMMISSION REPLIES

The Commission underlines that the implementation of European Development Funds (EDF) takes places in risky, complex and fast-evolving environments. It is characterised by diversity:

- in terms of geographical dispersion, covering many different Delegations around the world;
- in terms of implementing entities and partner countries with their diverse management and control capacities, ranging from small local NGOs to International Organisations;
- in terms of assistance delivery methods, including traditional projects, budgetary support, sectoral policy support programmes, contributions to global instruments, blending, budgetary guarantees, and other.

In addition, in 2021 the implementation of EDF-funded activities took place amid the challenges of the COVID-19 pandemic and the rapid political changes experienced by some of our partner countries.

The Commission considers that in this challenging context, a zero error scenario is unlikely. The Commission however takes all necessary measures to ensure full and efficient implementation of the EDF in accordance with the existing legal and financial framework. The Commission continues to adapt and refine its procedures to further reduce the risk of errors, taking into account the results of the ECA’s statement of assurance exercise. The action plan that is adopted every year by DG INTPA includes, among others, actions that target the reduction of errors such as simplification of procedures, guidance, trainings and awareness raising campaigns. To address the ECA’s 2021 recommendations on the EDF, the Commission will take further actions to strengthen its internal control system as deemed appropriate considering also cost efficiency.

REGULARITY OF TRANSACTIONS

Box 2 - Examples of errors

Absence of legal basis resulting in ineligible expenditure

As to the type of error occurred in the award of the grant contract with an international organisation in Niger, the Commission will take appropriate mitigating measures. However, the Commission points out that this project contributed considerably in improving the quality of public finance management. It assured the recovery of funds by public authorities, but also it limited the disturbance of the functioning of public services.
Absence of essential supporting documents

As regards the salary costs of the employee allocated to another project, the Commission points out that it was not possible to detect these ineligible costs from the documents that the International Organisation was required to provide for the release of the payment in compliance with the signed agreement. It should be emphasised that this is a very successfully implemented project that pioneered the promotion and development of commercial forestry value chain in Uganda and also demonstrated direct engagement for stimulating private sector investment.

Part of expenditure not incurred resulting in ineligible costs charged to the project

Regarding the amounts committed but declared as expenditure incurred, the Commission points out that as the final eligible amount will be determined only upon reception of the final report issued by the beneficiary, it considers the error as temporary. The amounts committed continue to be spent until the end of the project implementation.

The Commission is increasing awareness and controls in order to prevent the issue of excess clearing and requests clearer reporting from the entities concerned.

Serious failure to respect public procurement rules: unjustified decisions of the national authorising officer

Regarding the finding on the public procurement decision by the national authorising officer, the Commission emphasises that notwithstanding the difficulties faced during the procurement phase, the requested service has been successfully delivered. Restitution session has been organised with the participation of the Transport and Foreign Affairs Ministries and the provided recommendations have been endorsed as being very useful to improve the management of road maintenance in Mali.

22. The Commission operates in third countries in complex political and technical contexts, working together with many partners such as Partner Countries, International Organisations or Member State Agencies. While Action Plans are regularly run to keep error rates as low as possible, the Commission considers a zero-error scenario to be unlikely in this context.

23. The Commission notes that the majority of quantifiable errors that could have been avoided were due to excess clearing (ten cases) and several measures are ongoing to avoid this type of errors. Regarding the eight cases of the non-quantifiable errors, the Commission has disagreed with two of them and four others were referring to the same contract sampled four times for different transactions but with the same single error on a performance guarantee. The Commission notes that an error in a transaction does not necessarily equate to an amount unduly paid that must be recovered.

24. The Commission completed in 2022 the evaluation of the terms of reference for expenditure verifications in force since 2018. The conclusion was that they are effective in terms of follow up of ineligible expenditure (the expenditure verification report template includes an annex with the list of transactions and errors).

25. In September 2021 and May 2022, the Commission revised the terms of reference of expenditure verifications. The Commission foresees to further deepen the analyses and address other aspects such as sampling and to integrate the lessons learnt and the responses of a survey conducted in February 2022 of users of the Audit Framework Contract.
27. The Commission is aware of the cases of access to documents in read-only format identified by the ECA and continues to draw the attention of the concerned International Organisations of the United Nations to the need to provide the auditors with the necessary information.

The Commission is working closely with the International Organisations concerned and the ECA to find acceptable solutions to the issue of access to documents.

More specifically when these cases concerning three UN Organisations were brought to the Commission's attention, the Commission reacted quickly and enhanced the dialogue with the concerned UN Organisations to facilitate the Court’s ongoing work.

ANNUAL ACTIVITY REPORTS

28. The Commission's standing instructions provide that a reservation has to be issued when the residual error rate is above the materiality threshold of 2%.

In addition, the de minimis rule that was introduced with the 2019 Annual Activity Reports (AARs) provides that potential reservations are deemed not substantial for activities that represent less than 5% of the DG's total payments and have a financial impact of less than EUR 5 million. This allows the Commission to report only on the significant issues affecting the management of EU funds. Full transparency of the management reporting remains ensured: all cases for which the rule is applied are duly mentioned in the AAR and they are being closely followed-up.

For 2019 and 2020 the de minimis rule led to the absence of reservations, while for 2021 all indicative residual error rates were below the materiality threshold of 2%.

The 2021 Residual Error Rate study

31. The Commission agrees that the Residual Error Rate (RER) study is an important element underpinning the declaration of the Director General but is not the only source of assurance. DG INTPA has a comprehensive internal control framework and control strategy covering the full implementation cycle. All elements of the control framework serve as building blocks for its assurance which is reported in its AAR. The latter is the basis for the regularity information in the AMPR.

32. Besides the overall residual error rate, the RER study also estimates the error rate for the two funding streams EDF and EU Budget and the risk is shown in a differentiated picture (see table page 34 and Annex 9 to DG INTPA’s 2021 AAR showing the risk at payment by Relevant Control System).

33. The Commission does not characterise the RER study as an assurance engagement or an audit. It serves a specific purpose and is built on a distinct methodology.

This is disclosed in DG INTPA's Annual Activity Report, which presents complete management information in a true and fair manner. The Commission considers that the study is not subject to limitations that may contribute to an underestimation of errors.

34. The use of reliance in pursuit of the RER study has always been foreseen by the RER methodology. The full re-performing of a verification of an auditor such as the European Court of Auditors or a framework contractor would represent a large and unnecessary administrative burden
on beneficiaries and goes against the single audit principle. The degree of reliance cannot be pre-defined in advance, as it depends on the number of instances where reliance is possible and appropriate. The Commission agrees, however, that the degree of reliance should in principle not significantly exceed historic averages, unless there is a specific justification.

**Review of the 2021 AAR**

35. See Commission replies to paragraphs 28 and 31.

36. The Commission considers that the absence of a reservation is well justified in line with the Commission’s standing instructions for issuing reservations. It is the result of the comprehensive assessment of the different building blocks supporting the Director-General’s declaration of assurance made in the Annual Activity Report.

The Commission considers that the RER study is not subject to limitations that may contribute to an underestimation of errors.

**CONCLUSION AND RECOMMENDATIONS**

**Conclusions**

40. b) The Commission acknowledges that there are some errors in the transactions and is continuously working on preventive and corrective measures in order to address them.

The Commission notes that an error in a transaction does not necessarily mean an amount unduly paid that must be recovered.

**Recommendations**

**Recommendation 1 – Strengthen controls in respect of legal bases before signing contracts**

The Commission accepts the recommendation.

**Recommendation 2 – Deduct costs not incurred before payment or clearing**

The Commission accepts the recommendation and considers it as partially implemented. Following a previous ECA recommendation the Commission took measures such as issuance of guidelines, introduction of an additional checklist, awareness raising and continues to work towards preventing excess clearings.
COPYRIGHT

© European Union, 2022

The reuse policy of the European Court of Auditors (ECA) is set out in ECA Decision No 6-2019 on the open data policy and the reuse of documents.

Unless otherwise indicated (e.g. in individual copyright notices), ECA content owned by the EU is licensed under the Creative Commons Attribution 4.0 International (CC BY 4.0) licence. As a general rule, therefore, reuse is authorised provided appropriate credit is given and any changes are indicated. Those reusing ECA content must not distort the original meaning or message. The ECA shall not be liable for any consequences of reuse.

Additional permission must be obtained if specific content depicts identifiable private individuals, e.g. in pictures of ECA staff, or includes third-party works.

Where such permission is obtained, it shall cancel and replace the above-mentioned general permission and shall clearly state any restrictions on use.

To use or reproduce content that is not owned by the EU, it may be necessary to seek permission directly from the copyright holders.

Chapter 6:

- **Figure 6.4**: Created with “Tableau”, map background ©Mapbox and ©OpenStreetMap licensed under the Creative Commons Attribution-Share Alike 2.0 licence (CC BY-SA).
- **Box 6.3**: Left images from Copernicus Sentinel data (2021) processed by Sentinel Hub and the Andalusian paying agency.

Chapter 8 – Annex 8.1, EDFs – Annex I:

Created with “Tableau”, map background ©Mapbox and ©OpenStreetMap licensed under the Creative Commons Attribution-Share Alike 2.0 licence (CC BY-SA).

Software or documents covered by industrial property rights, such as patents, trademarks, registered designs, logos and names, are excluded from the ECA’s reuse policy.

The European Union’s family of institutional websites, within the europa.eu domain, provides links to third-party sites. Since the ECA has no control over these, you are encouraged to review their privacy and copyright policies.

**Use of the ECA logo**

The ECA logo must not be used without the ECA’s prior consent.
Our annual report presents our examination of EU revenue and expenditure, and our opinion on whether the EU’s annual accounts are reliable and the underlying transactions comply with the applicable rules and regulations.