



REPLIES OF THE EUROPEAN COMMISSION

TO THE EUROPEAN COURT OF
AUDITORS' SPECIAL REPORT

Protecting the EU budget: Better use of
blacklisting needed

Contents

| | |
|--|---|
| I. THE COMMISSION REPLIES IN BRIEF..... | 3 |
| a) General introduction..... | 3 |
| b) The Commission’s position on the key ECA observations and recommendations..... | 4 |
| c) Relevant latest developments and next steps..... | 4 |
| II. COMMISSION REPLIES TO MAIN OBSERVATIONS OF THE ECA..... | 5 |
| 1. Broadening EDES’ scope..... | 5 |
| 2. Making EDES more efficient..... | 5 |
| 3. Promoting the use of EDES as a tool for accountability..... | 5 |
| 4. Member States, exclusion and data-mining tools..... | 6 |
| III. COMMISSION REPLIES TO THE CONCLUSIONS AND RECOMMENDATIONS OF THE ECA..... | 7 |
| 1. Recommendation 1 - Expand the range of exclusion..... | 7 |
| 2. Recommendation 2 - Strengthen the early detection and exclusion system..... | 7 |
| 3. Recommendation 3 - Improve the implementation of early detection and exclusion under indirect management..... | 8 |
| 4. Recommendation 4 - Extend early detection and exclusion to shared management..... | 9 |
| 5. Recommendation 5 - Make better use of existing data and digital tools..... | 9 |

This document presents the replies of the European Commission to observations of a Special Report of the European Court of Auditors, in line with Article 259 of the Financial Regulation and to be published together with the Special Report.

I. THE COMMISSION REPLIES IN BRIEF

a) General introduction

The Early Detection and Exclusion System (EDES), introduced in 2016, aims at reinforcing the protection of the EU's financial interests.

This system, which applies to direct and indirect management, has brought improvements in relation to the application of administrative sanctions, in particular with regard to independence of assessments of exclusion situations, respect of fundamental rights, and transparency vis-à-vis the economic operators.

EDES requires a strong and fruitful interaction between the responsible authorising officer (RAO) and the EDES Panel. On the one hand, the RAO has the obligation to launch the administrative procedure, when he/she becomes aware of an exclusion case. The reason lies in the fact that the RAO has the knowledge of the contracts and grants signed, the overview of the relevant ongoing procedures, and the right to adopt immediate contractual measures to safeguard the Union's financial interests. On the other hand, the system enables to act against an unreliable economic operator also in the absence of a national final judgment or a final administrative decision, on the basis of a recommendation made by a centralized, inter-institutional Panel, that performs a preliminary classification in law of the facts and findings of the case.

The EDES Panel, presided by a standing high-level, independent chair, has provided from the start a powerful harmonization driver as opposed to the risks of diverging interpretations by different RAOs.

The EDES Panel has adopted 57 recommendations¹ including for the most serious misconduct, most of them resulting in corresponding exclusion decisions of the RAO.

The validity of EDES procedures has been confirmed by the European Court of Justice in two recent cases², whereby the Court has fully upheld the system and its features, including the role of the RAO and the authority of the Panel.

Finally, drawing from the lessons learnt since the creation of the system, the Commission had identified some of the weaknesses of the system and had started to take measures of administrative simplifications and awareness raising actions to enhance its effectiveness. Some of the improvements will however necessitate legislative modifications. Therefore, the Commission decided to table a proposal, expected to be adopted in the first semester of 2022, that will also cover some of the key observations raised by the European Court of Auditors (ECA) and further improve the overall system.

Against this context, the Commission welcomes the report of the ECA which will supports the Commission action in further improving the system (see further below).

¹ Out of over 100 referrals

² Cases T-672/19, *Indico* (EU:T:2022:64) and T-652/19, *Elevation* (EU:T:2022:63).

b) The Commission's position on the key ECA observations and recommendations

The ECA acknowledges that EDES has a broad range of exclusion situations and robust decision-making procedures.

The fact that Commission services have recorded relatively few exclusions in the system must be seen against the need to ensure a sound balance between the protection of the EU financial interests and the need to ensure the right of defence and other rights enshrined in the Charter of Fundamental Rights, by requiring the necessary level of substantiated evidence (established facts) checked through the exercise of the right to be heard. This is in line with due process and the rule of law principle, taking into consideration that an exclusion decision might have a significant economic and even social impact towards the entities that eventually are subject to exclusion decisions. Furthermore, the responsibility to refer cases to the EDES Panel lies with the RAO who makes a preliminary assessment of the case taking due consideration of specific circumstances of the case (*e.g.* need to ensure the continuity of service, the assessment of the remedial measures, proportionality and financial impact).

The Commission acknowledges that efforts must continue to provide the RAO with consolidated access to data sources to help them discover situations of exclusions keeping in mind the legal and technical obstacles.

The Commission also agrees that EDES should be further reinforced and will address the findings of the ECA, in particular regarding the extension of its scope.

Our replies to the main observations of the ECA are provided under sections II and III. The Commission accepts recommendations 1, 2(1), 2(2), 2(4), 2(5), 3, 4 and 5 and partially accepts recommendation 2(3).

c) Relevant latest developments and next steps

After a first term of office, a new chair and deputy chair, Ms Isabel Rofes and Mr Igor Ludborz respectively, took up duties in the EDES Panel as of November 2021. In addition, the rules of procedure of the Panel³ have been amended to introduce the possibility for a representative of the European Public Prosecutor Office (EPPO) to participate in the Panel's proceeding (observer status) when based on information transmitted by the EPPO.

As far as the extension to shared management is concerned, the Commission is taking steps to further enhance the protection of this large part of the budget while respecting the delegation of the tasks relating to budget implementation to Member States pursuant to Article 63(1) of the Financial Regulation. A targeted and proportionate extension of EDES to shared management taking into account the delineation of responsibilities between the Commission and Member States requires legislative changes which have to be proposed by the Commission as part of the revision of the Financial Regulation in the first semester of 2022.

³ Commission Decision (EU) 2018/1220 of 6 September 2018 on the rules of procedure of the panel referred to in Article 143 of Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council (OJ L 226, 7.9.2018, p. 7) as amended by Commission Decision (EU) 2021/1081 of 28 June 2021 (OJ L 234, 2.7.2021, p. 99).

II. COMMISSION REPLIES TO MAIN OBSERVATIONS OF THE ECA

1. Broadening EDES' scope

With a view to enhancing the effectiveness of EDES⁴, the Commission is working on a targeted proposal, in the context of the upcoming revision of the Financial Regulation, to broaden EDES' scope.

Under the new proposed rules, it will be possible to target three new categories of subjects, when falling in one or more exclusion situations: (i) beneficial owners, (ii) affiliated entities, and (iii) natural persons with power of control, management or representation. The inclusion of these new categories of subjects in the scope of EDES will serve the purpose of improving the overall effectiveness of the system by tackling the 'alter-egos' of the economic operators directly subject to exclusion, and which, without it, could have continued bidding for EU public contracts or otherwise benefit from EU funds.

In addition, three new grounds of exclusions with an appropriate penalty range will be added: (i) failure to cooperate in investigations, audits or checks carried out by EU enforcement bodies; (ii) taking advantage of a conflict of interest; (iii) incitement to hatred and discrimination.

The above changes would serve the purpose of enhancing the overall effectiveness of EDES. By widening its scope and substantive rules, EDES would be able to cover a broader range of exclusion situations and to better protect the Union's financial interests under all management modes.

2 Making EDES more efficient

In order to increase the efficiency of the EDES⁵, the Commission is also proposing to introduce in the upcoming Financial Regulation's revision:

- an expedited procedure for cases that need to be treated with priority, without prejudice to the right to be heard;
- improvements of the conditions for notifications of adversarial letters and decisions related to sanctions to unreliable economic operators who deliberately conceal their whereabouts to circumvent adverse consequences of their misconduct;
- an obligation upon the person or entity in an exclusion situation to substantiate the adequacy of the remedial measures taken by means of an external audit or a decision of a competent national or European authority.

Such improvements should result in faster exclusion decisions and a reduced administrative burden.

⁴ See section on "Direct management", para 21-29, of the special report.

⁵ See section on "Direct management", para 30-34, of the special report.

3. Promoting the use of EDES as a tool for accountability

Several actions are being put forward in order to promote the use of EDES⁶. This includes strengthening cooperation with relevant services, such as OLAF and – more recently – EPPO, by laying down working methods and procedures, but also assisting RAOs in bringing cases to the EDES Panel.

In this context, the cooperation between DG BUDG, as owner of the system, and OLAF has grown strong as confirmed by the ongoing cooperation in exchanges, development of guidelines, *ad hoc* trainings for the purpose of making OLAF reports more fit for the EDES procedure. A similar approach is already being adopted for what concerns cooperation with EPPO.

Furthermore, since the launch of EDES, the Commission services have focused on organizing training within the EU institutions, bodies and agencies to raise and maintain awareness on EDES procedures.

Templates, guidelines and procedures have been laid down in order to facilitate the work of the RAOs in gathering and transmitting relevant information on exclusion cases.

The Commission has also enhanced the corporate oversight, with the monitoring exercise on the follow-up to OLAF recommendations and recoveries⁷, as important steps to enhance the initiation of EU exclusion proceedings.

In the future, the Commission will further seek to enhance its activities regarding trainings and guidance, including to Member States authorities and implementing partners⁸.

4. Member States, exclusion and data-mining tools

With reference to extending EDES to Member States⁹, note that EDES is currently the only exclusion system operating at EU level. Although Member States are required to put in place effective internal control system to prevent, detect and correct irregularities and fraud, EU law does not require Member States to establish exclusion systems per se.

The Commission will propose to address the need of an enhanced protection of the Union's financial interests at EU level, via a targeted and proportionate extension of EDES to shared management.

Such proposal will be in full respect of the primary responsibility of the Member States in sanctioning and investigating such cases at national level under shared management. However, exclusion at EU level would be possible and necessary where:

⁶ See section on “Direct management”, para 36-64, of the special report.

⁷ Taking into account the deadlines referred to in OLAF Regulation for Member States and Institutions to follow up on the OLAF recommendations.

⁸ See section on “Direct management”, para 36-64, of the special report.

⁹ See section on “Direct management”, para 36-64, of the special report.

- The Member States notify the Commission via the Irregularity Management System (IMS) of any exclusion situation concerning the most serious misconducts (fraud, corruption, etc) established in a final judgment or final administrative decision. The Commission would then act on the basis of such information.
- Evidence of severe cases exists in the relevant EU report (i.e. OLAF report, Commission audit or ECA report) and there is, therefore, a need to protect the EU budget pending or lacking a final decision or judgment that could serve as basis for an exclusion decision (when such a final decision or judgment exists, the Panel must align immediately its recommendation to it).

Furthermore, Member States will have the obligation to consult the EDES Database and enforce the exclusion decisions therein. This means that they should not be able to award funds under shared management to a person or entity listed in EDES. The Commission recalls previous legislative proposals along the same lines to oblige Member States to take into account EDES exclusion when implementing the EU budget in shared management.

The Commission welcomes the ECA support as well as the European Parliament's support on such extension of EDES to shared management.

Finally, the Commission recalls that it has put forward proposals to improve the quality and interoperability of data collected by the Member States on recipients of EU funding where the budget is implemented under shared management and under the Recovery and Resilience Facility, including with the compulsory use of a single data-mining and risk-scoring tool. The agreed legislation however provides only for a voluntary use of the single data-mining and risk-scoring tool.

The Commission released and has been further developing the data-mining and risk-scoring tool "Arachne". Arachne is first a database of recipients and projects. The Commission will continue to modernise the tool, using the most recent technological developments (including artificial intelligence) and will continue to strongly promote the use of ARACHNE, and its new functionalities, by the Member States¹⁰.

In the context of the upcoming targeted revision of the Financial Regulation, the Commission will strive to further enhancing the protection of the EU budget and is considering proposing the use of the single data-mining and risk-scoring tool, across all methods of implementation of the EU budget.

III. COMMISSION REPLIES TO THE CONCLUSIONS AND RECOMMENDATIONS OF THE ECA

1. Recommendation 1 - Expand the range of exclusion

The Commission accepts this recommendation.

The Commission is proposing to extend, in the Financial Regulation, the scope of EDES. In this context, it would be possible to target three new subjects : beneficial owners, affiliated entities and natural persons involved in the misconduct. The possibility to exclude them will be subject to individual assessments, in line with the European Parliament's recommendation, in order, for example, to make the difference between direct and indirect involvement in exclusion situations, in order to avoid that

¹⁰ See section on "Shared management", para 73-81 and 82-87, of the special report.

entities which did not effectively exercise influence on the involvement in the exclusion situation are unfairly registered in EDES, in accordance with the principle of personal responsibility.

2. Recommendation 2 - Strengthen the early detection and exclusion system

The Commission partially accepts this recommendation.

With reference to the specific sub-recommendations, the Commission notes the following:

1. The Commission accepts recommendation 2(1).

The Commission is developing an internal case management system, capable of providing an overview of the treatment of EDES ongoing and closed cases. The system will be developed with due regard of confidentiality requirements and privacy considerations.

2. The Commission accepts recommendation 2(2).

The Commission, under the umbrella of the Commission's corporate management board, initiated a corporate oversight of the effective operation of the EDES, in particular on the follow up of OLAF's reports and recommendations concerning early-detection or exclusion and the follow up of the Panel's recommendations. The Commission should also provide for a corporate oversight in relation to ongoing OLAF's¹¹ and EPPO's investigations – while fully respecting possible confidentiality requirements – as well as final audit results, competition decisions, and implementing partner notifications. The roles of RAO and the EDES panel in harmonising the response to exclusion situations must remain unaffected.

When it comes to the use of available data sources to identify exclusion cases, the Commission will explore the possibility to oversee RAO's actions when information on potential exclusion cases is recorded in the relevant database. For IMS data, the records are made available when the RAO finds a hit in the system and requests further information.

3. The Commission partially accepts recommendation 2(3).

The Commission does not solely rely on declarations on honour. On top of the verification of such declarations, the Commission provides for some ex-post safeguards. In particular, the Commission requires the RAO to verify the EDES Database at all stages of the procedures before contract signature. Ex-post checks are also ensured by means of blocking warnings in ABAC linked to excluded entities before payments are made. The system will also warn them if an early detection was introduced in EDES. Thus, authorising officers can be made aware in the course of contract implementation of issues related to EU counterparties with whom they have an ongoing contractual relationship.

However, the Commission will explore the possibility of setting up a one-stop shop for Member States' authorities with the ambition of drawing on relevant available data from EDES, Arachne and linked to Summa (the future application replacing ABAC) to ensure a

¹¹ Reference to "ongoing OLAF investigations" should be understood as referring to precautionary administrative measures to protect the financial interests of the Union as described by Article 7 (6) of Regulation 883/2013 (OLAF Regulation).

maximum protection of the EU budget through interconnection, cross-feeding and AI-based tool and techniques. Please see in addition the reply under recommendation 5.

4. The Commission accepts recommendation 2(4).

The Panel Secretariat has developed different guidelines to facilitate cooperation with OLAF and other services for the maximum effectiveness of EDES procedures. This includes guidance on the use of OLAF's reports¹², guidance on the impact of exclusions on ongoing legal commitments, EDES corporate guidance, etc. The Commission will develop further guidance regarding the use of EDES.

5. The Commission accepts recommendation 2(5).

The Commission will continue to promote awareness of EDES, including within other EU institutions and bodies, Member States authorities and implementing partners.

3. Recommendation 3 - Improve the monitoring of early detection and exclusion under indirect management

The Commission accepts this recommendation.

Indirect management is based on reliance on the rules of the partners and on the recognition of their administrative autonomy, management declarations and related audit opinions provided by partners. The partners' rules and procedures are pillar assessed in order to ensure that e.g. the rules of exclusion of the partner have functioned satisfactorily.

Against this background, the Commission will take an additional step to ensure that its partners fulfil their obligation to notify the Commission when counterparties are identified as being in exclusion situations by updating the management declaration models to add a specific reference to the obligation to inform the Commission of cases of detected fraud and/or irregularity in application of Article 142(2) e) FR). In addition, the awareness of partners implementing funds under indirect management could be raised to remind them of their obligations to inform.

4. Recommendation 4 - Extend early detection and exclusion to shared management

The Commission accepts this recommendation.

In the context of the upcoming revision of the Financial Regulation, the Commission is proposing a targeted and proportionate extension of EDES to shared management, as well as the obligation for Member States to check the EDES database and take into consideration the exclusions therein when awarding EU funds. The targeted extension of EDES to shared management is due to the need to respecting the delegation of the tasks relating to budget implementation to Member States pursuant to Article 63(1) of the Financial Regulation.

¹² The instructions on drafting, and the Guidelines on monitoring of OLAF administrative recommendations have been finalised and apply as from January 2022

5. Recommendation 5 - Make better use of existing data and digital tools

The Commission accepts this recommendation.

With reference to the specific sub-recommendations, the Commission notes the following:

1. The Commission accepts recommendation 5(1).

The Commission will carry out a mapping exercise and has initiated a proof of concept to identify the availability of data. The outcome of the exercise will however depend on the availability of national data.

2. The Commission accepts recommendation 5(2).

The Commission's intention in the revision of the Financial Regulation is to propose to use available national data. The Commission will further extend the legal basis for the use of other relevant national data contained in the Irregularity Management System reported by Member States to initiate EDES Panel proceedings and for the related exclusion decisions to be enforced by Member States for shared management's expenditure. These are the national sources most relevant for the protection of the EU budget. The Commission is also analysing the feasibility of linking EDES, the Irregularity Management System and Arachne. Due to national rules, especially on data protection, the Commission cannot collect and re-use data without due process.

3. The Commission accepts recommendation 5(3).

The Commission will continue to develop the integrated IT system for data-mining and risk-scoring Arachne that it has made available to Member State authorities implementing the EU budget. These developments will include new features and functions such as an ex-ante module, developments from the CAP and new risk indicators to take into account beneficial ownership data. The Commission will also aim at improving its user-friendliness and, to the extent that national data is made available by Member States, its interoperability with other sources of EU and national data relevant for EU budget implementation. In the context of the upcoming targeted revision of the Financial Regulation, the Commission will strive to further enhancing the protection of the EU budget and is considering proposing the use of such integrated IT system for data-mining and risk-scoring, across all methods of implementation of the EU budget.

4. The Commission accepts recommendation 5(4).

The Commission is responsible for making available EU exclusion decision in the EDES Database and strives for the maximal promotion of the tool. The Commission will also take further step to promote, at corporate level, the use of the integrated IT system for data-mining and risk-scoring tool currently named Arachne.

5. The Commission accepts recommendation 5(5).

Please see the reply to recommendation 5(3).